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Nos. 22187 and 22187-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

IRVING NINBERG and IDA NINBERG; BEN NINBERG and MOLLIE NINBERG,

Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

On Petition to Review the Decisions of the Tax Court of the United States.

APPELLANTS' OPENING BRIEF.

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TABLE OF AUTHORITIES CITED

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Basis of Jurisdiction.

This is an appeal of the decision of the Tax Court of the United States. Appellants were mailed Notices of Deficiency by the Commissioner of Internal Revenue on or about September 25, 1964 [Clk. Tr. 9, 24]. Within ninety days thereafter (on or about December 21, 1964), appellants filed a Petition with the Tax Court [Clk. Tr. 1, 16], thereby granting jurisdiction in that tribunal pursuant to Sections 6213, 6214, and 7442 of the Internal Revenue Code (26 U.S.C.).

Jurisdiction is vested in this Court by Section 7482 of the Internal Revenue Code (26 U.S.C. 7482) which confers exclusive jurisdiction in the United States Court of Appeals to review decisions of the Tax Court.

Pursuant to Section 7483 of the Internal Revenue Code (26 U.S.C. 7483), appellants filed a Petition for Review within three months of the filing of the decision of the Tax Court [Clk. Tr. 59], thereby granting jurisdiction to this Court.

Specification of Errors.

1. The Court below erroneously determined that appellants were not entitled to deduct as a business bad debt the worthless obligations of Bur-Val Manufacturing Company, Inc., owed to appellants. The Court ruled that the deduction was allowable as a non-business bad debt rather than as a business bad debt.

2. The Court below erred in failing to question whether appellants' acts in guaranteeing the obligations of Bur-Val Manufacturing Company, Inc. were significantly motivated by appellants' trade or business. Rather, it sought their "major concern" [Clk. Tr. 54].

3. The Court below erred in failing to find that the guaranteeing of obligations of Bur-Val Manufacturing Company, Inc. was proximately related to appellants' trade or business.

4. The Court below erred in the following findings of fact:

   A. "So far as the record shows petitioners would have been able to obtain more highly remunerative employment and a higher rent for the San Francisco building from another business than they were obtaining from Bur-Val." [Clk. Tr. 50].

   B. "Since Bur-Val was the tenant in petitioners' building, it is obvious that putting up the collateral was for the benefit of petitioners' tenant but the only benefit shown by this record in put-

ting up the collateral to petitioners as distinguished from Bur-Val was to keep Bur-Val operating and protect their investment in Bur-Val." [Clk. Tr. 50].

C. "Furthermore, the record shows that beginning sometime in 1961, Bur-Val was not paying rent when it fell due." [Clk. Tr. 53].

Further specification of the above errors is found in the argument below.

Statement of the Case.

The Commissioner determined that deductions claimed on the joint 1962 Federal Income Tax Returns of each of the appellants in the amount of $18,806.74, claimed as a loss of the partnership known as Irving and Ben Ninberg, was erroneous. The $18,806.74 ordinary loss of each of the appellants was converted to a short-term capital loss of $21,848.94, and ordinary income of $3,240.27. This transformation was accomplished by disallowance of a deduction claimed by the partnership as a business bad debt, and allowing the same deduction as a non-business bad debt (I.R.C. §166(d), found in Appendix).

The bad debt deduction in question resulted from the satisfaction of guarantees by the appellants of obligations of Bur-Val Manufacturing Company, Inc., appellants' wholly owned corporation. Appellants urged in the Court below that the deduction was properly claimed as a business bad debt while the Commissioner contended that the deduction was allowable as a non-business bad debt—thereby deductible only as a short-term capital loss. The lower Court agreed with the Commissioner. The issue is whether the obligations arose in connection with the trade or business of appellants. (I.R.C. §166(d)(2)).

ARGUMENT.

I.

Introduction.

The rule of law relied upon by the Lower Court is summed up on page 18 of the Court's Memorandum Opinion [Clk. Tr. 55], where the Court attempts to ascertain whether there was a proximate relationship between the loans in question and the taxpayers' businesses:

> "In seeking this 'proximate connection', we must examine factors other than motivation, particularly those which illustrate the degree of *necessity* and *directness of effect* of the loan to the corporation upon the taxpayers' other business. Not only have we found lack of necessity and directness of effect, but also, we have found other objective factors which negate petitioners' expression of intent. Thus, petitioners have not proved that they were either 'significantly' or 'primarily' motivated by their other business." (Emphasis added).

Throughout the Lower Court's opinion it appears to set forth a test for determining the proximate relationship between the loans and the businesses of the taxpayers. It notes that the petitioners' investment, salary, and rental interests "were thoroughly intermingled", but that the investment in Bur-Val was the *major* concern [Clk. Tr. 54]. This conclusion—that the investment in Bur-Val was appellants' *major* concern—is not supported by the record, and the Court's finding that appellants' investment, salary and rental interests were thoroughly intermingled furnishes the significant, if not major, motivation necessary to classify the loss as a business bad debt.

The findings of the Lower Court involve the interpretation of Internal Revenue Code Section 166(d)-(2). The issue is a mixed one of law and fact, and is subject to review by this Court. The question is whether the Tax Court correctly applied the statute to the factual situation which it found to exist. *Lundgren v. Commissioner of Internal Revenue* (9th Cir., 1967), 376 F. 2d 623, 627; *United States v. Keeler* (9th Cir., 1962), 308 F. 2d 424; *Commissioner of Internal Revenue v. Smith* (2nd Cir., 1953), 203 F. 2d 310, 311; *Washburn v. Commissioner of Internal Revenue* (8th Cir., 1931), 51 F. 2d 949, 951.

In the recent case of *Generes v. United States* (E.D. La., 1967), P.H. 67-5205, 67-2 U.S.T.C. 9754, the Court's jury instructions contain what appellants consider to be the most current statement of the law on this issue. Among the instructions were:

1. "A debt is proximately related to the taxpayer's trade or business when its creation was significantly motivated by the taxpayer's trade or business, and it is not rendered a non-business debt merely because there was a non-qualifying motivation as well, even though the non-qualifying motivation was the primary one."
2. ". . . you are instructed that rendering services for pay does constitute a trade or business. An officer of a corporation who receives a salary as such is considered in the eyes of the law to be engaged in a trade or business—the trade or business of rendering services for pay."
3. "A debt is a business bad debt if the debt, or the activity giving rise to the debt, is such that without the taxpayer assuming or acquiring it

his trade or business would no longer be able to operate in the manner in which it is intended to operate."

4. The Court said the jury should consider whether the taxpayer was ". . . motivated significantly by a desire to protect his salary or whether his motivation was predominantly one of protecting his investment and future gain or investment as distinguished from his salary as an officer-employee."

5. The Court instructed the jury to further consider ". . . the amount of Mr. Generes' investment in the company which he would be protecting by signing the indemnity agreement, and what was the amount of annual salary he would be protecting thereby."

Appellants believe that each of the above instructions are supported by substantial authority cited below. The trial Court did not give proper consideration to the above tests, and for this reason was in error.

II.

Appellants' Trade or Business.

A. Business Motivated Loans as Contrasted With Investment Oriented Loans.

The Supreme Court decision in *Whipple v. Commissioner of Internal Revenue* (1963), 373 U.S. 193, 83 S. Ct. 1168, is the landmark case when considering the distinction between business and non business bad debts. This decision makes a crucial distinction between loans motivated to produce investor-type income ("dividends or enchancement in the value of an investment") and those motivated by non-investor type activities. A care-

ful analysis of the Court's narrow holding is most enlightening (373 U.S., at 202):

> "Devoting one's time and energies to the affairs of a corporation is *not of itself, and without more,* a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enchancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. *When the only return is that of an investor,* the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation." (Emphasis added).

This Honorable Court has recently had an opportunity to consider the distinction between loans motivated to produce investor type income and those motivated by non-investor type activities. In *Lundgren v. Commissioner of Internal Revenue, supra,* the Court stated (376 F. 2d at 627, 628):

> "The holding of *Whipple* was that the furnishing of regular services to one, or many, corporations cannot constitute an independent trade or business where the taxpayer's motivation is that of an investor and gain is sought in the form of dividends or enchancement in the value of the investment. This is so, the Court reasoned, because

previous cases had established that 'investing is not a trade or business' within the meaning of the statute, and where a taxpayer seeks a return in the form of dividends or enchancement in the value of an investment 'this return is distinctive to the process of investing * * *' Id. at 202, 83 S.Ct. at 1174. Hence, the Court concluded:

> Absent substantial additional information furnishing management and other services to corporations for a reward not different from that flowing to an investor in those corporations is not a trade or business under § 23 (k) (4) (the predecessor of § 166 under the Internal Revenue Code of 1939). (Footnote omitted.) Id at 203, 83 S.Ct. at 1174."

. . .

"These are not the kinds of gains marking an investor's return, characterized in *Whipple* as gain from dividends or enchancement in the value of the investment. It may be true, as respondent points out, that one who has advanced substantial sums to a corporation in which he holds a controlling interest will expect an economic benefit from the investment over and above the normal remuneration for services rendered. But as respondent's stipulation recognizes, and as the Tax Court found, this expectation need not always take the form of an investor's return. *It is the kind of return the lender seeks that Whipple emphasizes;* and where the return sought is shown to be different from that flowing to an investor, *Whipple* leaves open the question whether a taxpayer's services to his corporation may constitute an independent trade or business." (Emphasis added).

Appellants will demonstrate that they were engaged in two businesses—furnishing services as employees in return for compensation, and leasing real estate—and, that the loans in question were made for the purpose of furthering those businesses.

B. The Business of Performing Services as an Employee.

In *Whipple v. Commissioner of Internal Revenue, supra,* the Supreme Court stated that performing services to a corporation, in and of itself, does not constitute a trade or business; however, the Court noted at 373 U.S. 204, 205:

> "Nor need we consider or deal with those cases which hold that working as a corporate executive for a salary may be a trade or business, E.g., *Trent v. Commissioner,* 291 F.2d 669 (C.A.2d Cir.). Petitioner made no such claim in either the Tax Court or the Court of Appeals and, in any event, the contention would be groundless on this record *since it was not shown that he has collected a salary from Mission Orange or that he was owed one.* Moreover, there is no proof (which might be difficult to furnish where the taxpayer is the sole or dominant stockholder) that the loan was necessary to keep his job or was otherwise proximately related to maintaining his trade or business as an employee. Compare *Trent v. Commissioner,* supra." (Emphasis added).

When discussing whether petitioner's services as a corporate executive for a salary constituted a trade or business, the Supreme Court noted in footnote 12 that under the net operating loss carryover provisions, and under the Internal Revenue Code sections relating to

ordinary and necessary expenses of a trade or business, the performance of personal services as an employee is considered carrying on a trade or business.

The case of *Trent v. Commissioner of Internal Revenue* (2nd Cir., 1961), 291 F. 2d 669, 674, contains an extensive study into the question of whether performing services as an employee constitutes engaging in a trade or business under Section 166 of the 1954 Internal Revenue Code. The Supreme Court, in *Whipple, supra,* did not specifically affirm or overrule the decision in *Trent,* but rather raised an issue as to the proximate relationship of the debt incurred therein to the employment status. The decision in *Trent* is scholarly and well reasoned. The Court spends a great deal of time reviewing the definition of "trade or business" as applied to the employee status under other Internal Revenue Code sections. It is noted that five courts of appeals have held that being a corporate employee is a "trade or business" under Section 172(d)(4) of the 1954 Internal Revenue Code. The Court also noted that:

> ". . . the decided weight of authority long has been that a corporate officer may deduct expenses paid or incurred which were incident to the 'trade or business' of being a corporate employee . . .",

under Section 162(a) of the 1954 Code (291 F. 2d, at 674). Petitioners consider the *Trent* case, *supra,* to be compelling authority for the position that performing services as an employee constitutes a trade or business.

Since *Trent, supra,* the rule has become rather well settled that performing services in return for compensation constitutes engaging in a trade or business. *Lundgren v. Commissioner of Internal Revenue, supra; Wed-*

dle v. Commissioner of Internal Revenue (2nd Cir., 1963), 325 F. 2d 849, 851; *Kelly v. Patterson* (5th Cir., 1964), 331 F. 2d 753.

Irving Ninberg was President of Bur-Val and was in charge of the office and sales personnel. Ben held the office of Secretary in the corporation and was in charge of production. The record indicates that appellants were performing substantial services for Bur-Val Manufacturing Company, and that they received substantial salaries for their services. During the years 1959 and 1960, Irving and Ben Ninberg each received a salary of $34,500.00 annually [Exs. 1-A, 2-B, 5-E, 6-F]. The Commissioner has never attacked the reasonableness of these salaries. When asked what his trade or business was during the year 1957, Irving Ninberg replied that he was employed by the Bur-Val Manufacturing Company [Tr. 11]. In response to the question of why the petitioners had guaranteed the purchases of Bur-Val Manufacturing Company from Harvey Aluminum Company, Irving Ninberg replied, in part, that the corporation was paying his brother and him a fair salary [Tr. 17].

The Court notes that if the corporation had ceased business the petitioners would have lost their employment [Clk. Tr. 49, 50]. It states,

> "So far as the record shows petitioners would have been able to obtain more highly remunerative employment . . . than they were obtaining from Bur-Val."

This conclusion is *entirely without foundation* as the possibilities of employment elsewhere—other than at Bur-Val—were not considered by either party, and there is no testimony on this point.

The Lower Court also notes:

> "Petitioners' argument that the guarantee was connected with continued receipt of their salaries is unpersuasive. They withdrew large salaries for two years and then none at all when the corporation's business was less profitable. Thus, they also sacrificed this non investor's return to the welfare of the corporation." [Clk. Tr. 53].

The Court obviously used this fact to conclude that the appellants' testimony to the effect that they wished to protect their jobs lacked credibility. Such a finding is unwarranted. *Lundgren v. Commissioner of Internal Revenue, supra.*

In *Lundgren, supra,* the Court of Appeals for the Ninth Circuit reversed a decision of the Tax Court (T.C. Memo 1965-314). The petitioner therein had done business in the form of a partnership. The partnerships existence was terminated, and a portion of the assets were transferred to RushMore Corporation. RushMore needed funds for expansion and attempted to secure a loan of $250,000.00 from the United States Small Business Administration. As a condition of the loan, the SBA required the petitioner to act as a guarantor of said loan and to advance an additional $145,000.00 of his own money to the corporation. He was also required to make all personal sales to said corporation at cost, and to draw no salary until the SBA loan had been repaid. RushMore subsequently ceased doing business and the taxpayer sustained a loss of $129,000.00. The issue before the Court was the business vs. non-business character of the loan.

The Tax Court had held that the taxpayer was not engaged in business as an employee of RushMore.

The Court of Appeals reversed on this point, and also found that the loans were made in connection with that trade or business.

The Court noted at pages 627-628:

> "It may be true, as respondent points out, that one who has advanced substantial sums to a corporation in which he holds a controlling interest will expect an economic benefit from the investment over and above the normal remuneration for services rendered. But as respondent's stipulation recognizes, and as the Tax Court found, *this expectation need not always take the form of an investor's return.* It is the kind of return the lender seeks that *Whipple* emphasizes; and where the return sought is shown to be different from that flowing to an investor, *Whipple* leaves open the question whether a taxpayer's services to his corporation may constitute an independent trade or business.
>
> . . .
>
> "We having found petitioner to be in the trade or business of rendering managerial and other services to RushMore, it follows that the debt involved here bore that proximate relationship to this trade or business which satisfies the 'in connection with' requirement of the statute. . . . RushMore's existence depended upon its ability to obtain the financing necessary to put its South Dakota operations under way. *If the SBA loan had not gone through, the corporation—and petitioner's job with it—would have been finished. In a direct sense, therefore, the advances were related to petitioner's trade or business activities in connection with*

> *RushMore.* See *Weddle v. C.I.R.,* 325 F.2d 849, 851 (C.A.2, 1963).
>
> "In so holding, we reject the Tax Court's conclusion that petitioner could not have been in the business of providing services to RushMore because he never received a salary from RushMore. Conditions of the SBA loan prohibited RushMore from paying its officers any salary without the SBA's permission. In all his previous timber and lumber enterprises petitioner's gain was realized through the sale of timber at a profit and receipt of a salary for services rendered, and petitioner's testimony that RushMore was formed to provide more of the same kind of gain as soon as the SBA restrictions were removed is *not disputed. In determining whether the services rendered a corporation constitute the conduct of a trade or business, the anticipated gain need not be realized immediately.* (Citation) *That gain will not be recognized until some future time is but one factor to be considered in determining whether the loss claimed arose from a trade or business activity of the taxpayer or from activities peculiar to an investor.*" (Emphasis added).

The Lower Court in this case was strongly influenced by the fact that petitioners reduced their salary when the corporation incurred financial difficulties, and based upon this fact, chose to disbelieve the petitioners' statements of their intent. *Lundgren, supra,* clearly points out that it is the long term anticipated gain which is to be considered, and that a temporary failure to receive the anticipated income should not be the sole determining factor.

The Lower Court also states the following [Clk. Tr. 52]:

> "Intentions alone cannot make a bona fide business expense out of an item which is not necessary to the conduct of the business. Therefore, the courts have looked to see if the loan to the corporation was required of the shareholder if he seeks to justify it by his employment status. Even though a stockholder is not actually required to make the loan by the deeds of his personal business, a fairly direct and clearly beneficial effect on his personal business interest has been held to cause the bad debt."

The Courts should not look to see if the loan was required by the shareholder—at least, should not give this factor great weight. In *Weddle v. Commissioner, supra,* the Court expanded the philosophy of the *Trent* case to cases where the employee is also the controlling stockholder:

> "That Mrs. Weddle, unlike Trent, did not have to fear being fired by a superior is also not at all conclusive as to what she was trying to protect; she would have been fired soon enough if the company had to cease operations through inability to obtain credit—as she was when it ultimately did." (325 F. 2d, at 851).

The Court in *Weddle* realistically stated that executives in a corporation need not be warned about losing their job, but, rather can intelligently ascertain that same will be nonexistent should the corporate employer be forced to close its doors. See also the cases of *Kelly v. Patterson, supra; Lundgren v. Commissioner, supra.*

C. Business as Lessor.

In *Whipple v. Commissioner, supra,* the Supreme Court reversed the decision of the lower court for the following reason (373 U.S. at 205):

> "We are more concerned however, with the evidence as to petitioner's postiion as the owner and lessor of the real estate and bottling plant in which Mission Orange did business. The United States does not dispute the fact that in this regard petitioner was engaged in a trade or business (footnote 13: *Although petitioner received no rental payments* form Mission Orange, there was rent owing to him under the 10-year lease agreement.) but argues that the loss from the worthless debt was not proximately related to petitioner's real estate business. *While the Tax Court and the Court of Appeals dealt separately with assertions relating to other phases of petitioner's case, we do not find that either Court disposed of the possibility that the loan to Mission Orange, a tenant of petitioner, was incurred in petitioner's business of being a landlord.* We take no position whatsoever on the merits of this matter but remand the case for further proceedings in the Tax Court." (Emphasis added).

The above quotation demonstrates that the Government conceded that *Whipple's* position as the lessor of the property used by his corporation constituted a trade or business.

In *Mahoney v. Spencer* (9th Cir., 1949), 172 F. 2d 638, 640, the taxpayer owned all of the shares of three corporations. He also owned plants which he leased to each of those corporations. The leases provided that

as landlord he agreed that he would provide adequate financing for each corporation's operation. The Court of Appeals held that these factors, as established in the District Court below, justified the holding of that Court that the taxpayer was engaged "in the business of acquiring, owning, expanding, equipping and leasing food processing plants."

In *Commissioner of Internal Revenue v. Moffat* (3rd Cir., 1967), 373 F. 2d 844, 847, the Court noted that the business of owning and leasing coal lands constituted a trade or business. In explaining the decision of the Tax Court below (T.C. Memo 1965-183), the Court noted that it was not necessary to *operate* the coal lands in order for the owning and leasing of same to constitute a trade or business.

Irving and Ben Ninberg were in the business of leasing the San Fernando building to Bur-Val on a five-year lease commencing October, 1959, at $3,000.00 per month [Stip. 3, Clk. Tr. 33; Tr. 15]. During the calendar year 1961, the year in which the transactions in question took place, the partnership of Irving and Ben Ninberg received gross rental income of $40,800.00, and realized a net income of $12,408.98 [Ex. 9-I]. The appellants each reported the following sums of rental income from the San Francisco building:

Year	Income
1959	$ 1,400.60
1960	9,770.88
1961	6,204.49
1962	(18,806.74)

The rental loss for the year 1962 includes the bad debt deduction now at issue. Without considering the bad

debt deduction, each partner realized income in the amount of $3,240.53 by renting the San Francisco property to Bur-Val Manufacturing Company.

In addition to the San Fernando property, Irving Ninberg had some interest in two other rental properties during the years 1959-1962.

Bur-Val occupied the San Fernando building under a sub-lease prior to its purchase by appellants. The corporation paid $1,500.00 rent per month to the sublessor although the sub-lessor was paying $3,500.00 per month to the owner of the property. Appellants purchased the San Fernando building and land in October of 1959 for $255,000.00 and leased it to Bur-Val for $3,000.00 per month. The sum of $55,000.00 was paid as a down payment, and appellants agreed to pay $2,500.00 per month for three years, at which time the balance would become due. The interest rate was 6½%.

The above represent findings of fact by the Lower Court [Clk. Tr. 41]. The Court also found that the petitioners guaranteed obligations of Bur-Val to Harvey Aluminum Co. in August of 1961. Ben and Irving were anticipating a need to refinance the San Fernando property because the final lump sum payment would be due in October of 1962. The appellants stated that the guarantees were made in order to keep a tenant in the San Fernando property so that the purchase loan could be refinanced. In response to a question as to the appellants' intent in acquiring the San Fernando Road property, Irving Ninberg stated [Tr. 15]:

> "Well the same as the other rentals I have acquired that at one time we would be able to take care of my brother and myself after we wouldn't be able to physically work."

The assets of Irving and Ben Ninberg were given as collateral for the Bank of America loans because [Tr. 16]:

> "Well, for one thing, that the borrowing was getting quite large, and the bank wanted more security than just a personal guarantee for the amount of money that we were borrowing, and we figured that we would guarantee the amount due to the fact that we would have a tenant that would be in the property at all times."

The Harvey Aluminum guarantee was entered into because of even more demanding circumstances. That company was the corporation's principal supplier [Tr. 17]. Harvey Aluminum demanded a guarantee because of the weakness of the entire aluminum industry at that time, and,

> "My brother and I, as I stated before, were in a process of re-negotiating for the mortgage on the property, and we felt that we would rather keep the Bur-Val alive and have it as a tenant in the property, and we signed a guarantee to Harvey." [Tr. 31].

A more detailed statement of the problem facing the petitioners is found in the Transcript at page 17. Irving states:

> "Well, we figured that at the time that the corporation was paying both my brother and myself a fair salary, and that in order to keep the corporation alive so that we would have a tenant because at that particular time our mortgage with Mr. Carter was almost to a point where he had to refinance.

> "We tried to refinance. We were turned down by both Bank of America and Gibralter Savings. At that particular time they told us to come back at a future date at which time they would refinance the property. We figured that at that time it would be wise for us to have a tenant so that we could refinance at the time when we can go back either to Gibralter or the Bank of America."

Ben Ninberg similarly stated that the Harvey Aluminum guarantee was entered into because of the problems surrounding the refinancing of the property, and the need to retain the tenant. When asked what would have happened if they had not signed the guarantee, Mr. Ninberg replied, "We just wouldn't have no tenant." He also stated that, "With a tenant in the place then we were able to refinance the property." [Tr. 40].

On cross-examination, Ben Ninberg was asked why he put up the building as a guarantee of the obligations of Bur-Val to Harvey Aluminum. Mr. Ninberg replied that if the corporation didn't have any metal, it was out of business, and that he was more concerned about having a tenant in the property than about staying in business,

> ". . . because we had a lot of money involved in the property, and I didn't want to lose the property and lose the tenant and lose everything." [Tr. 44].

The guarantee of the Bur-Val Manufacturing Company obligations to Harvey Aluminum by the petitioners was limited to the extent of their equity in the properties on San Fernando Road and Lake Street [Ex. 19-S]. Each of these properties was used by the

corporation during the period 1957-1963 [Tr. 13]. The evidence above clearly demonstrates that there was an absolute need to refinance the San Fernando Road property; that if the collateral agreement and guarantee were not executed the corporation would be deprived of its source of financing to meet its ever-changing business needs, and its source of metals, and would then be forced to cease business operations. *Without the tenant, renegotiation of the financing would be impossible; without renegotiation of the financing, the property would be lost.* Therefore, the petitioners had nothing to lose by guaranteeing the Harvey Aluminum obligations to the extent of their equity in the real estate.

Why did the Lower Court choose to disbelieve the uncontradicted testimony of the petitioners that they intended to keep a tenant in the San Feranando property to assure refinancing of the property, and subsequent rental income?

The Court states that beginning sometime in 1961 Bur-Val was not paying rent when it fell due, and concluded that such a tenant would hardly be well regarded by a prospective financier [Clk. Tr. 53]. The partnership tax return for the year 1961 [Ex. 9-I] shows rental income from the San Fernando building of $40,800.00. The monthly rental was $3,000.00, which should have produced an annual rental income of $36,000.00. The Court's finding of fact is therefore contrary to the evidence.

The Lower Court also states that appellants could have received a higher rent from an unrelated tenant [Clk. Tr. 49, 50]. This finding is again unsupported by the evidence as Bur-Val was able to rent the property for $1500.00 a month from an unrelated lessor,

but Bur-Val paid $3,000.00 a month to appellants. We ask: Were the appellants, in light of the rental charged, most concerned with their business as lessors, or with the corporation's business. The record demonstrates that the appellants primarily were interested in benefiting themselves as lessors.

III.

Relationship to Individual Trade or Business.

It is well established in the case that a taxpayer may deduct worthless loans receivable as business bad debts when the loans are related to his individual trade or business. The standard to be used in determining whether the loans are sufficiently related to this individual trade or business is unclear. Section 166(d)(2) of the Internal Revenue Code of 1954 defines a non-business debt as any debt other than "a debt created or acquired (as the case may be) *in connection with* a trade or business of the taxpayer; or a debt the loss from the worthlessness of which *is incurred* in the taxpayer's trade or business."

The standard set by the statute—"in connection with" or "incurred in" a taxpayer's trade or business—is uncertain so the Commissioner drafted regulations to clarify the test. Tres. Reg. Sec. 1.166-5(b) states:

> ". . . The question whether a debt is a non-business debt is a question of fact in each particular case. The determination of whether a loss on the debt's becoming worthless has been incurred in a trade or business of the taxpayer shall, for this purpose, be made in substantially the same manner for determining whether a loss has been incurred in a trade or business for the purposes of Section 165(c) (1).

For purposes of subparagraph (2) of this paragraph, the character of the debt is to be determined by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt comes within the exception provided by the subparagraph. The use to which the borrowed funds are put by the debtor is of no consequence in making a determination under this paragraph . . ."

The problem, of course, is that the standard of "proximate relationship" is no clearer than the standard found in the statute, *i.e.,* "in connection with" the taxpayer's trade or business. The Courts have attempted to fill the void by defining when a loan is proximately related to the individual's trade or business. The Court-created standard looks to the motive of the taxpayer to determine whether the proximate relationship exists.

The only case to thoroughly discuss a precise standard is *Weddle v. Commissioner of Internal Revenue* (2nd Cir., 1963), 325 F. 2d 849, 851. The Court stated:

"Here the Tax Court, recognizing the law to be as we had stated, rested its denial of a deduction on a factual finding that, unlike Trent, Mrs. Weddle had failed to sustain her burden of showing that protection of the trade or business of employment had been a *significant motivation* for endorsing the notes. . . . So here particularly in view of the back-handed wording of Section 166, it suffices for deduction that the creation of the debt

should have been *significantly motivated by the taxpayer's trade or business, even though there was a non-qualifying motiviation as well.* But this, we believe, was the standard the Tax Court in fact employed." (Emphasis added).

The Court examined the law of torts in determining how the concept of "proximate" causation was to be interpreted, and found that a cause contributing to harm may be found proximate despite the fact that it might have been secondary to another contributing cause. In a concurring opinion, Judge Lombard felt that the standard should be one of "primary and dominant" motivation, rather than "significant" motivation.

In *Kelly v. Patterson* (5th Cir., 1964), 331 F. 2d 753, 757, the Court noted the majority and concurring opinions in *Weddle, supra,* and concluded that,

> "It appears then that the only problem under facts such as those here presented of loans by a *majority stockholder-employee* to the corporation is to determine whether the debt qualifies as trade or business incurred on any statutory basis, *and this depends on the motiviation of the taxpayer in making the loans which created the debt.*" (Emphasis added).

The Court concluded that the taxpayer had not met her burden under either of the standards asserted in *Weddle,* but clearly indicated that the motivation of the taxpayer was the controlling factor.

In *Lundgren v. Commissioner of Internal Revenue, supra,* this Court noted at p. 628:

> "RushMore's existence depended upon its ability to obtain the financing necessary to put its South Dakota operations underway. It the SBA loan

> had not gone through, the corporation—and petitioner's job with it—would have been finished. In a direct sense, therefore, the advances were related to Petitioner's trade or business activities in connection with RushMore. See *Weddle v. C.I.R. . . .*"

After favorably citing *Weddle supra,* the Court noted that the advances were made to an enterprise distinct from, but "directly related to and formed in aid of" the petitioner's individual business. (376 F. 2d 628). The direct relationship found in *Lundgren* was no greater than that existing in this case, as will be discussed below.

The Tax Court has taken a variety of positions in attempting to define the necessary relationship between business loans and the taxpayer's individaul trade or business. In *J. T. Dorminey,* 26 T.C. 940, 945, the Court found that the advances were incidental to and proximately related to the petitioner's individual trade or business. This case was cited with approval by the Supreme Court in *Whipple v. Commissioner of Internal Revenue, supra,* in Footnote 11. "The significant motiviation" test was used in *Raymond E. Morrow,* (appealed by taxpayer to C.A.8th). Some Tax Court cases still define the issue as determining the taxpayer's dominant or primary motive; see *e.g. Philip W. Fitzpatrick,* T.C. Memo 1967-1, where the Court found that the taxpayer's dominant motive was to protect his employment.

The Lower Court noted that it is proper to search for the motive of a shareholder in making a loan or guaranteeing a corporate obligation. In determining the actual motive, courts consider the expressed subjec-

tive intent and the external objective facts, such as percentage of ownership of the corporation by the stockholder-guarantor, the value of the taxpayer's equity in the corporation, the value of salary received, and the ratio between the equity in the corporation and other interests which might have influenced the taxpayer's action. After this generally accepted statement of law, the Court notes [Clk. Tr. 52]:

> "The Courts look beyond motive, however, in searching for 'proximate relationship.' Intentions alone cannot make a bona fide business expense out of an item which is not *necessary* to the conduct of the business. Therefore, the Courts have looked to see if the loan to the corporation was required of the shareholder if he seeks to justify it by his employment status. Even though a stockholder is not actually required to make the loan by the needs of his personal business, a fairly direct and clearly beneficial effect on his personal business interests has been held to cause the bad debt to be considered a business bad debt." (Emphasis added).

The above statement demonstrates that the Court was not solely concerned with motivation, but that it also considered the actual necessity of the loans to further the taxpayer's individual business. Such a test is improper and cannot be supported by the volumes of case law discussing the issue of business vs. nonbusiness bad debts. This Court expressly rejected a similar argument in *Mercer v. Commissioner of Internal Revenue* (9th Cir., 1967), 376 F. 2d 708, 710, 711, in which the Court determined that expenditures in raising cattle were deductible as business expenses,

rather than non-deductible hobby expenses. The Court noted that:

> "Unquestionably, however, in this circuit the rule is that a taxpayer's venture is a trade or business if he has a good faith expectation of profit from that venture, irrespective of whether or not others might view that expectation as reasonable . . . Here the taxpayer entered into a venture with a good faith expectation of profit. Whether that expectation was foolhardy or shrewd is of no moment. The taxpayer expended his effort and capital to the limit of his available time and resources. There can be no conclusion other than that the taxpayer's venture, though small in results, was a trade or business within the meaning of Sections 162 and 165."

As in *Mercer, supra,* it is improper in this case to question whether the loans were actually needed to further the taxpayer's trade or business. The proper test to be employed is whether the taxpayer guaranteed the loans in question while motivated to protect his individual trade or business by saving his job or rental property.

Conclusion.

The Court must determine, relying upon the evidence presented at trial, whether the acts of appellants in guaranteeing the corporate loans of Bur-Val Manufacturing Company were "investment" oriented or promoted by an "income protection" motive.

Appellants believe that the evidence presented at trial clearly demonstrates that they were concerned about losing their jobs at Bur-Val Manufacturing Company, and further concerned with the possibility that they

would be stranded without a tenant at that crucial time when the San Fernando Road property had to be refinanced. As appellants controlled Bur-Val Manufacturing Company, they were not concerned about the possibility of being fired. They were, however, realistically apprehensive about the possibility that Bur-Val Manufacturing Company might be forced to cease doing business. This, in fact, happened through the occurrence of various transactions in 1961 and 1962, and appellants found, as they had anticipated, that jobs paying them $34,500.00 per year vanished. The San Fernando Road property was also lost—not sacrificed for the sake of Bur-Val Manufacturing Company, the "corporate entity"—but rather realistically pledged as security in a desperate attempt to generate salaries and a substantial rental income for appellants.

The record before the Court does not detail the complete history of Bur-Val Manufacturing Company from its inception in mid-1957 through its demise in 1963. Financial data pertaining to appellants and Bur-Val Manufacturing Company for the years 1959-1962 is found in the record, and an analysis of these years furnishes ample evidence of the fact that appellants were significantly motivated when guaranteeing and paying the obligations to Bank of America by their desire to obtain substantial salary and rental income.

Appellants testified that the corporate obligations were guaranteed because the corporation was paying them a fair salary [Tr. 17], and because it was necessary to keep a tenant in the San Fernando Road property [Tr. 16, 17, 40, 44]. Appellants were particularly concerned about the need to refinance the San Fernando Road property, since the note was due in 1962. They

believed they had nothing to lose by guaranteeing the obligations in question, and incurring future obligations, as it will be demonstrated below that their investment in the corporation was nominal, while their investment in the rental property was great. Appellants do not suggest that the success of the corporation was not a factor. Of course it was. What we respectfully suggest though, is that there were tiers of priority, to wit: (1) protect the property—rent, (2) protect the salaries, (3) protect the corporate stock.

Appellants believe that the Lower Court disregarded the evidence which we feel substantiates the appellants' oral expression of their motivation—the disparity in value between the combined salary-rental income—investment in real property, as contrasted with appellants' investment in the "corporate entity"—Bur-Val Manufacturing Company.

The cases place a great deal of emphasis on the factor just discussed. In *Whipple v. Commissioner of Internal Revenue, supra,* 373 U.S. at 196, the Court noted that Whipple's bad debt deduction amounted to $56,975.10, while his investment in the real estate in question amounted to but $43,601.00, but the Supreme Court directed the lower court to rule on this issue. In *George P. Weddle* (1962), 39 T.C. 493, 497, affirmed 2nd Cir., 325 F. 2d 849, both courts pointed out that the corporation's net worth varied between $204,000.00-$337,000.00 in the relevant years, while the salary that the petitioner was attempting to protect was approximately $18,000.00 per year. This comparison aided the courts in determining the petitioner's motivation.

In *Frank A. Garlove,* T.C. Memo 1965-201, the Court relied on the same theory—comparing the investment with the claimed income protection motivation:

> "Respondent's contention that the petitioner advanced $15,000.00 to protect a capital investment of $7,040.00 in a small company is unsupported by the record and unsounded in theory. The mere fact of stock ownership in the debtor corporation is not significant by itself to overcome the weight of petitioner's evidence that the primary purpose of the loan was to aid petitioner's business."

The Court also noted that, "by helping the company to continue its operations as profitably as possible, the petitioner hoped to get future business."

The following schedule demonstrates the total capital investment of appellants in Bur-Val Manufacturing Company [Exs. 13-M through 16-P]:

Taxable Year Ended	Common Stock	Earned Surplus	Total Capital Investment
4/30/59	25,000.00	22,735.99	47,735.99
4/30/60	25,000.00	43,075.73	68,075.73
4/30/61	25,000.00	(9,031.47)	15,968.53
4/30/62	25,000.00	(4,623.11)	29,623.11
4/30/63	25,000.00	(111,069.74)	(86,069.74)

Besides having a limited capital investment in Bur-Val Manufacturing Company, that investment was financially unproductive as the corporation had never paid dividends [Tr. 18, Clk. Tr. 40]. Contrast the above capital investment in Bur-Val Manufacturing, particularly the investment as of April 30, 1961 (under $16,000.00) and April 30, 1962 (under $30,000.00), with the appellants' investment in the real estate located at

3000 North San Fernando Road. The down payment in 1959 was $55,000.00, and additional payments were made in the amount of $2,500.00 per month (including interest at 6½%) [Clk. Tr. 41]. In all, appellants invested in excess of $100,000.00 in the San Fernando Road property [Tr. 40]. The comparison of the investment in the capital stock ($15,000.00-$30,000.00) with the investment in the real estate (in excess of $100,000.00) is concrete, tangible evidence of appellants' intent when guaranteeing the obligation to Harvey Aluminum Company and furnishing collateral for the bank loans. Contrast the comparative investments above with those discussed by the courts in the *Weddle, Whipple* and *Garlove* cases quoted above.

The Lower Court apparently accepted the above evidence, finding:

> "Although the evidence is not clear on this point, it appears that their equity in the building substantially exceeded their equity in the corporation. Nevertheless, other factors indicate that petitioners' expressed intent was not their real intent." [Clk. Tr. 53].

Appellants believe that the trial Court did not give proper weight to the above comparison; rather it relied on less significant factors that were, for the most part, not supported by the record.

The law is clear that a corporate entity is a taxpayer distinct from its shareholders and employees. Yet, when determining the motivation of appellants herein, the legal distinction is less meaningful than the in-

dividual's intentions. Irving Ninberg stated why the corporate form of business was chosen [Tr. 19]:

> "Well, because of the other assets my brother and I both have, we figured it would save us for (from) any kind of lawsuits, or things like that that might prevail."

That statement presumably means that the corporate form was chosen for the manufacturing operation in order to limit individual liability from that venture. The true business interests of appellants were obtaining a "fair salary" [Tr. 17] and paying off the mortgage on the real estate. These two objectives motivated appellants' actions during the years in question.

We believe that appellants are described by their own words in the record. They emerge as hard working people with the traditional goals of bettering themselves and their families. They were interested in social security—the personal kind; not the Government variety. Therefore, they personally invested in income property in the reasonable anticipation of developing passive income to provide for their wants when they become older [Tr. 15]. The program of paying the purchase price on the San Fernando Road property in the partial sum of $90,000.00 (including interest) over a three-year period would create a larger equity, and upon refinancing for a more orthodox period, a dramatic cash flow would have presented itself. That the plan was aborted signals a minor economic tragedy.

Following the purchase of the building in 1959, all business activity was directed to that day when the property would be refinanced and a substantial rental income would result. The Court's own analysis [Clk.

Tr. 42] of the income of appellants for the years 1959-1962, belies its later conclusion that the protection of rental income from the San Fernando Road property was not foremost in appellants' minds in the years in question. The income schedule of Ben and Mollie Ninberg presents the evidence in its purest form. Ben had no sources of income other than his salary and rental income from Bur-Val Manufacturing Company—income from his individual trade and business. When Bur-Val did well during 1959 and 1960, it was the individual appellants who reaped the benefit, *not Bur-Val Manufacturing Company.* Appellants each received a salary exceeding the corporation's earnings [Clk. Tr. 40, 42]. While the Lower Court relies upon the fact that the salary was terminated in the years 1961, and 1962, each of the appellants received income of $6,204.49 from the San Fernando Road building during the year 1961. During 1962, the year in which the corporation suffered its sharp loss, each petitioner still received $3,-240.00 in rental income from the San Fernando Road property (when disregarding the business bad debt deduction). It is this financial independence that appellants were attempting to develop, and would have developed had they been able to refinance the San Fernando Road property.

Appellants and the Commissioner agreed that the transactions in question were entered into for the purpose of sustaining Bur-Val Manufacturing Company. With the corporation successfully engaging in business, it could realistically pay the appellants substantial salaries, and guarantee them a tenant whom they knew and could rely upon. It is not difficult to see why appellants wanted to rent the property to a tenant whom

they knew—such a lease furnishes security, and that was the goal of appellants. The Commissioner contended that appellants wished to protect their investment in the corporation, and the trial Court agreed. Yet each failed to face the vital question: What investment? for it is indeed the substantial investment in the San Fernando Road property, as contrasted with the small investment in Bur-Val Manufacturing Company which lends tangible, concrete support to the appellants' testimony of their motivation and intent to protect their jobs and investment in the San Fernando Road property.

Respectfully submitted,

Bruce I. Hochman and
Harvey D. Tack,
Attorneys for Appellants.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

BRUCE I. HOCHMAN

HARVEY D. TACK

APPENDIX.

Table of Exhibits.

Exhibit	Identified	Offered	Received
Joint Exhibits 1-A to 11-K, 13-M to 19-S	3	3	4

Statute—Internal Revenue Code of 1954.

Sec. 166. BAD DEBTS

(a) General Rule

(1) Wholly Worthless Debts. There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

(2) Partially Worthless Debts. When satisfied that a debt is recoverable only in part, the Secretary or his delegate may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

. . .

(d) Nonbusiness Debts

(1) General Rule. In the case of a taxpayer other than a corporation.

(A) subsections (a) and (c) shall not apply to any nonbusiness debt; and

(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months.

(2) Nonbusiness Debt Defined. For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than

(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

Nos. 22,188 and 22,188-A

United States Court of Appeals

For the Ninth Circuit

Beverly J. McConnell, *Appellant*, vs. Estate of Butler, *Appellee*,	No. 22,188
and Oscar Stroble, Trustee, *Appellant*, vs. Estate of Butler, *Appellee*.	No. 22,188-A

On Appeal from the United States District Court for the District of Arizona

APPELLANT'S OPENING BRIEF

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FERNAU-WALSH PRINTING CO., SAN FRANCISCO

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United States Court of Appeals

For the Ninth Circuit

BEVERLY J. McCONNELL, *Appellant,* vs. ESTATE OF BUTLER, *Appellee,*		No. 22,188
and		
OSCAR STROBLE, Trustee, *Appellant,* vs. ESTATE OF BUTLER, *Appellee.*		No. 22,188-A

On Appeal from the United States District Court for the District of Arizona

APPELLANT'S OPENING BRIEF

STATEMENT OF JURISDICTION

This is an appeal by an attorney for a bankruptcy trustee from an Order of a bankruptcy Referee—as affirmed by a District Court—setting her fee for legal services rendered to the trustee in the course of administering a bankruptcy estate.

The Referee's jurisdiction to set the fee rests on § 38(6), 11 U.S.C. § 66, of the Bankruptcy Act.

The District Court's jurisdiction to review the Order of the Referee rests on § 39c, 11 U.S.C. § 67, of the Bankruptcy Act.

This Court's jurisdiction rests on §24a, 11 U.S.C. §47, of the Bankruptcy Act.

STATEMENT OF THE CASE

On October 4, 1966, after her appointment as counsel for the bankruptcy trustee on August 5, 1963, Appellant was awarded a fee of $8,000.00 (A.R. 112). Appellant's requested fee was $30,000.00 (R.T. 42-45). The total estate of the bankrupt when reduced to money by the trustee amounted to approximately $254,153.51, consisting of: $49,313.84 turned over to the trustee by the receiver; $88,000.00 from the sale of the merchandise inventory, furniture and fixtures, and name; accounts receivable collected by forwarders outside the State of Arizona, $26,600.27; accounts receivable collected in Arizona, $59,638.85; and 4% interest from depository bank on estate funds deposited as of September 30, 1967, $30,600.55.

The trustee of bankrupt was appointed and qualified on the 5th day of August, 1963 (A.R. 26).

Upon the trustee's qualification, he received from the receiver, in money, $49,313.84; all the physical assets of bankrupt that had come into the hands of

the receiver, consisting of merchandise, furniture and fixtures; and accounts receivable.

The trustee conducted the business of the bankrupt from August 5, 1963, until August 22, 1963, on which date the merchandise and name were sold by the trustee for $88,000.00 and the furniture and fixtures were sold for $4,000.00.

In the schedules of bankrupt, its merchandise inventory was shown as being of the value of $35,500.00. It was appraised by court-appointed appraisers as being of the value of $72,042.00. The trustee sold same for $87,000.00.

The furniture and equipment were scheduled by bankrupt as being of the value of $1,650.00 and appraised by court-appointed appraisers as being of the value of $4,320.00. They were sold by the trustee for $4,000.00.

The name of bankrupt was not scheduled as an asset, nor was it appraised as having any value by the court-appointed appraisers, but the name was sold to the purchaser of the merchandise inventory for $1,000.00.

The bankrupt scheduled its accounts receivable as being of the face value of $288,752.93 and valued the same at $50,000.00. The receiver, prior to August 5, 1963, collected, of the accounts receivable of the face value of $288,752.93, the sum of $21,356.50. The face value of accounts receivable coming into the hands of the trustee was $267,396.43. Concerning these ac-

counts receivable, the Referee said, on page 5 of his Certificate on Petition for Review, that:

> "The debtors petition classified and divided the accounts receivables into four groups. Group I, with a total amount outstanding of $31,500 with 75% of these current. Group II, were those accounts receivables on open or extended terms with a total outstanding of $95,000 with 75% of this group being current. The other two groups of accounts receivables were classified as doubtful or uncollectable. The total of these two groups was $162,000 . . ."

There was a bid made at the first meeting of creditors to purchase the accounts receivable for $29,500.00. The Referee in charge of the proceedings was disposed to approve a sale of all of the accounts receivable for this offer of $29,500.00. Appellant, as attorney for the trustee, so vigorously opposed a sale of the accounts receivable (aided by the creditors' committee and others) that the Referee reluctantly authorized the trustee to collect the accounts receivable, rather than confirm a sale of same.

Appellant's law firm, Wilson & McConnell, for a period of a great many years next last past, has maintained an efficient and effective collection agency as a part of its law officers.

Appellant forwarded to out-of-state attorneys and collection agencies selected accounts receivable for collection. From the efforts of such attorneys and collection agencies, including the prosecution of seven suits in the courts, a gross sum of $26,600.27 was

collected. These attorneys and collection agencies charged and deducted from the monies collected, for their fees and commissions, $5,107.36; and the out-of-state collections thus netted the estate $21,492.91. The Referee approved the fees and commissions charged by out-of-state attorneys and collection agencies and the deduction of their fees and commissions from the gross collected and the remittance to the trustee of the net remaining of $21,492.91. The fees and commissions of out-of-state attorneys and collection agencies amounted to 19.2% of the gross amount collected.

Appellant, through the facilities of her law office, pursued, diligently and actively, the collection of accounts receivable after August 5, 1963, and by such efforts, including the commencement of eleven suits in the Court, collected $59,638.85.

Appellant was of such stature with the Bank of Douglas in Phoenix that she, alone, arranged for this lawfully-designated and qualified depository bank to pay 4% interest on the funds of the estate deposited into the bank. In this District, it is believed, this was the initial or first time interest was ever paid on funds of a bankruptcy estate deposited into a lawfully-designated and qualified bank depository. The service of Appellant in obtaining interest on funds of the estate deposited in the bank is entitled to real consideration and substantial monetary reward. Interest at 4% on the estate funds received by the trustee as of September 29, 1967, amounted to $30,600.55.

It is obvious that the Referee's findings do not give a reasonable fee based upon the value of legal services in this District, because the Referee found that more than 100 hours had been devoted to the performance of the duties of Appellant as attorney for the trustee.

On November 2, 1966, Appellant filed her Petition for Review of the Order of the Referee of October 4, 1966, which Order of the Referee was based on the Findings of Fact and Conclusions of Law of the said Referee, dated October 4, 1966.

On March 20, 1967, the Referee filed his Certificate on Petition for Review.

On April 5, 1967, Appellant filed her Objections to Referee's Certificate on Review and her Request for Amendments thereto, for the reason that the Referee's Certificate did not comply with the provisions of Section 39(a)8 of the Bankruptcy Act, in that said Certificate did not contain either a transcript of the evidence or a summary thereof, nor did the Referee send up to the District Court the pertinent records pertaining to attorneys' fees.

On April 27, 1967, the United States District Court entered its Order that the Objections to the Certificate of Review were overruled and that the Referee's Findings of Fact and Conclusions of Law and Order for Fees and Allowances were approved; and on June 26, 1967, formal written Judgment to the same effect was entered.

On June 1, 1967, Appellant filed her Notice of Appeal to the United States Court of Appeals for the

Ninth Circuit from the Order of the District Court of April 27, 1967, and on July 3, 1967, filed her Amended Notice of Appeal from the Judgment of the District Court overruling the trustee's Objection to Certificate of Review and sustaining the Referee's Findings of Fact and Conclusions of Law and Order for Fees and Allowances to Beverly J. McConnell, attorney for the trustee.

Appellant's Appeal was timely perfected (R.T. 133 and R.T. 138).

The principal issue before this Court on this Appeal is whether the $8,000.00 fee allowed Appellant was so low under the circumstances as to amount to an abuse of discretion.

SPECIFICATION OF ERRORS

1. The Referee and the District Court erred in awarding the Appellant a fee that is less than fair and reasonable under settled bankruptcy principles.

2. The Referee and the District Court erred in awarding Appellant a fee that did not take into consideration the prevailing fees or commissions for the forwarding of accounts receivable to out-of-state attorneys and collection agencies for collection.

3. The Referee and the District Court erred in awarding the Appellant a fee that did not take into consideration the prevailing fees or commissions for the collection of accounts receivable in the Arizona District.

4. The Referee and the District Court erred in not awarding the Appellant any fee for procuring more than $30,600.55 in interest from the depository Bank of Douglas on the estate funds deposited therein.

5. The fee of $8,000.00 allowed to Appellant was so low under the circumstances as to amount to an abuse of discretion.

6. The Referee and the United States District Court were acting under the same misapprehension of the law in the allowance of the $8,000.00 fee to Appellant as the Referee and the United States District Court acted in their allowance of fee to attorney for trustee considered by this Court in the case of *Jacobowitz v. Double Seven Corporation* decided by this Court on June 5, 1967. 378 F.2d 405.

SUMMARY OF ARGUMENT

1. All authorities agree that an attorney for a bankruptcy trustee is entitled to a fair and reasonable fee for necessary professional services competently rendered.

2. The $8,000.00 fee allowed Appellant, as attorney for trustee, was so low under the circumstances as to amount to an abuse of discretion.

3. The Referee and the United States District Court, in allowing Appellant's fee, did so under a misapprehension of the law.

4. The fee of $8,000.00 allowed Appellant, as attorney for the trustee, was not a reasonable fee based upon a consideration of the judicially-accepted criteria for fee allowance.

5. A reasonable fee on all pertinent bases of allowance under the circumstances of this case was $30,000.00, the amount sought by Appellant.

6. The results of the services of Appellant as attorney for the trustee greatly added to the money amount of the estate.

7. The fee sought ($30,000.00) is objected to by only one creditor, and not by the creditors' committee. The objecting creditor is the Estate of Walter H. Butler, Deceased, and his estate is a creditor by virtue of his relationship with the bankrupt in consequence of which he paid loans made by the Crocker Citizens National Bank (formerly Citizens National Bank) and the United California Bank (formerly California Bank) under guarantees he executed in his liftetime. This creditor belongs to a specialty group and is not one of the ordinary creditors.

ARGUMENT

I. A REASONABLE FEE TO BE PAID AN ATTORNEY FOR A BANKRUPTCY TRUSTEE IS NO DIFFERENT FROM A REASONABLE FEE IN PRIVATE EMPLOYMENT, EXCEPT THAT THE SPIRIT OF THE BANKRUPTCY ACT WOULD SEEM TO REQUIRE A COURT TO FIX SUCH FEE AT THE LOWER END OF THE SPECTRUM OF REASONABLENESS.

This Court, in *Jacobowitz v. Double Seven Corporation*, 378 F.2d 405, decided on June 5, 1967,

rendered a judgment which appears to be decisive in this case, in favor of Appellant.

The Bankruptcy Act itself does not prescribe an objective criterion for determining the quantum of the fee. However, all authorities agree that the fee allowed should be fair and reasonable under the circumstances of the particular case and that such determination is left to the sound judicial discretion of the Bankruptcy Courts. In the case now before the Court, the following elements are to be considered:

(a) The period of time elapsing during which services were rendered (since August 5, 1963);

(b) The time devoted in rendering services (some 200 hours);

(c) The size of the estate.

(d) The responsibility of the attorney, her stature, standing and ability;

(e) Obtaining agreement with the approved depository bank for the payment of interest on the funds of the bankruptcy estate on deposit (interest thus collected, more than $30,600.55);

(f) The facilities for collecting accounts receivable made available by attorney for trustee in the law office maintained by her and her partner and their unusual experience in collecting accounts receivable.

(g) The services of counsel sought and obtained by the trustee in the conduct of the business of bankrupt and the administration of the bankruptcy estate;

(h) The advantage measured in money realized by the estate directly as the result of services rendered to the trustee;

(i) The efforts of the attorney for the trustee in dissuading the Referee from approving sale of all accounts receivable at first meeting of creditors for $29,500.00;

(j) The aid given the trustee by Appellant as attorney in the operation of the business of bankrupt and in selling the business as a going concern for $92,000.00;

(k) The forwarding of selected accounts receivable to out-of-state attorneys and collection agencies and supervising the handling, resulting in the collection of a gross amount of $26,600.27; netting the estate $21,492.91 after the approval of the retention by out-of-state attorneys and collection agencies of $5,107.36 for their fees and commissions.

(l) The fact that the services rendered by the attorney for the trustee were rendered at the command and with the full knowledge and approval of the trustee.

See:

Section 62 of the *Bankruptcy Act* (11 U.S.C.A. § 102); *In Re Owl Drug Co.* (1936), 16 F.Supp. 139 (D.C. Nev); affirmed sub nom; *Cohen v. Elder,* 9 Cir., 90 F.2d 823; *In Re Barceloux* (1935), 9 Cir., 74 F.2d 288; *Sampsell v. Monell* (1947), 9 Cir., 162

F.2d 4; 3 *Collier on Bankruptcy,* 14th Ed., Sec. 62.12 (4) & (5); 6 *Remington on Bankruptcy,* 5th Ed., Sections 2672 & 2673; *Central Trust Co. v. Wabash, St. L. & P. Ry. Co.* (C.C. Mo. 1887), 32 F. 187, 188; *Realty Associates Securities Corporation v. O'Connor* (1935), 295 U.S. 295, 299, 55 S.Ct. 663, 79 L.Ed. 1446; *In Re Gilbert* (1928), 276 U.S. 294, 296, 48 S.Ct. 309, 72 L.Ed. 580, 16 F.Supp. 139, 142; *Monaghan v. Hill* (1944), 9 Cir., 140 F.2d 31; Canon 12 of the *Canons of Ethics of the American Bar Association;* 7 *Am. Jur.* 2d, Attorneys at Law, Secs. 235-247; 56 *A.L.R.* 2d 13, 18-48; *In Re Seed Marketing Association* (1964), 228 F.Supp. 812, 820 (D.C. Neb.); 39 *Referees Journal* 34, April, 1965; 6 *Remington on Bankruptcy,* 5th Ed., Section 2682, pp. 228-229; 3 *Collier on Bankruptcy,* 14th Ed., Sec. 62.12(5), pp. 1488-1489; *In Re Belfort Corp.,* 136 F.Supp. 1, 4-5 (D.C. Mo. 1955); *In Re Standard Gas & Electric Co.* (1939), 3 Cir., 106 F.2d 215, 216-217; *In Re Mt. Forest Fur Farms of America* (1946), 6 Cir., 157 F. 2d 640, 647; and *Finn v. Childs Co.* (1950), 2 Cir., 181 F.2d 431, 435-436.

We agree with what this Court said in the *Jacobowitz* case, supra, and we are so impressed by the statement that, for emphasis, we quote from the opinion, page 408:

> "Admittedly, the economical spirit of the Bankruptcy Act is one of the considerations going into the determination of a reasonable fee in bankruptcy cases, but it is only one consideration to be weighed and valued along with others. There

is, of course, no precise measure for reasonableness. The court in a given case fixes the fee after a consideration of various elements * * *"
"* * *"

"Determining reasonable fees in bankruptcy cases is no different from determining them in private employment, except that the spirit of the Bankruptcy Act would seem to require a court to fix such fees at the lower end of the spectrum of reasonableness."

II. THE REFEREE AND THE DISTRICT COURT ACTED UNDER A MISAPPREHENSION OF THE LAW IN THE ALLOWANCE OF A FEE OF ONLY $8,000.00 TO APPELLANT. AN $8,000.00 FEE IS SO LOW UNDER THE CIRCUMSTANCES AS TO AMOUNT TO AN ABUSE OF DISCRETION.

The Referee, in his Certificate on Review, on page 5, stated:

"The petition of the attorney for the receiver/trustee for fees and allowances presented a most difficult question to the Referee."

The allowance of a reasonable fee was "a most difficult question" for the Referee because the Referee, as stated in the *Jacobowitz* case, supra, page 408:

"believed himself compelled by the economical spirit of the Bankruptcy Act to cut to an appreciable degree every request for attorneys' fees, no matter how low they might appear upon the scale of reasonableness when measured by private employment standards."

No doubt, also, the Referee had in mind and considered statistical averages of administrative expenses

incurred in closing cases generally throughout the United States.

May it not be reasonably assumed that the District Judge was likewise influenced by the same considerations that made the question a difficult one for the Referee?

We call attention to the fact that the Referee and the District Judge deciding the *Jacobowitz* case were a different Referee and a different District Judge from the Referee and Judge who decided the instant case. However, it is the same Court, though presided over by a different Referee and a different Judge. Was not the same misapprehension of the law present in the instant case that was present in the *Jacobowitz* case?

The time of Appellant devoted to aiding the trustee in the conduct of the business, the sale of the assets of the business, and to ordinary administrative matters in a case of the size of the estate of bankrupt, considered in the light of the success attained and a good sale and a good administration of the estate, is such that a reasonable fee would surely be more than the fee of $8,000.00 allowed. The minimum fee basis of $35.00 an hour prevailing in this District ought not to be, in this case, the basis of a reasonable allowance, even "at the lower end of the spectrum of reasonableness". This minimum fee, basically, is used by the young, inexperienced and unspecialized lawyers. Such a minimum-fee basis of charge has little application to the experienced, specialized practitioner.

Collections on Selected Claims Forwarded for Collection Outside of Arizona

The sum of $26,600.27 was collected outside of Arizona on claims forwarded out for collection. The charges paid to those collecting the accounts outside of Arizona were 19.2%, or $5,107.36. In an ordinary case of a private business, on claims forwarded by one in the position of Appellant and with collections supervised as Appellant supervised the collections outside of Arizona, the reasonable and usual fee to the forwarding attorney would be one-third of a collection charge of not less than 25% and as much as one-third of the gross amount collected. Since there was retained, with approval of the Court, 19.2% of the gross collections of $26,600.27, a reasonable fee to Appellant for these collections alone would be 9.6%, or $2,553.60.

Accounts Collected in Arizona

Appellant, basically, supervised the collection of accounts receivable through the collection department in her law office. However, in addition, she instituted eleven suits in the Courts. Now, what is a reasonable fee for the collection, in Arizona, of $59,638.85? Twenty-five per cent, by standards applicable to private businesses, would be low. One-third would be the usual, but if we should say 20% as a basis, that would surely be "at the lower end of the spectrum of reasonableness" and Appellant would be entitled to a fee, on the collection of $59,638.85, of $11,927.70. It should be here considered that 65% of this $11,927.70, or $7,753.00, would just pay the out-of-pocket ex-

penses of Appellant for the services of the collection department maintained in her law offices. Collection agencies and collection departments in law offices do not run themselves. They have to be supervised. Among other expenses: There is office rent. There is clerical expense. There is stenographic expense. There is telephone expense. There is expense for stamps and envelopes. It is for all of these expenses that Appellant was out of pocket 65% of whatever fee is deemed to be reasonable for the collection of $59,638.85. It is only 35% of such an amount that would constitute a fee to Appellant. There has been no charge made, paid or sought for these expenses for these collections. On a 20% basis of collection, the out-of-pocket expense of Appellant in making the collections through the collection department in her law office would amount to $7,753.00. Appellant had out-of-pocket expenses only $247.00 less than the total allowed fee of $8,000.00. While it is true the out-of-pocket expense is an estimate of $7,753.00, it is a known fact and certain that the out-of-pocket expense in making the collections by the use of the facilities of the collection department in Appellant's office amounted to a very substantial sum and may well have exceeded $7,753.00.

Four Per Cent Interest on Deposits of Estate Funds

It is evident from the Referee's Certificate on Review that he gave no consideration in fixing the fee of Appellant to her services in arranging with the depository Bank of Douglas for the payment of 4%

interest on deposits which, as of September 30, 1967, has increased the estate of the bankrupt by $30,-600.55. Until this case, the payment of interest by a depository bank on funds of a bankrupt deposited therein was unheard of. Before, everyone's efforts to get interest were totally unsuccessful. Appellant, alone being responsible for the arrangement for the lawfully-designated and qualified depository bank to pay 4% interest on the funds of the estate deposited into the bank, is entitled to great consideration. A substantial fee allowance for this service to the trustee and the estate must be made if she is to be reasonably compensated for her services. The result of this arrangement with the depository bank, alone, has increased the estate of the bankrupt by an amount of money sufficient to pay Appellant the $30,-000.00 fee she seeks.

The Time Element

In Paragraph 10 of the Referee's Findings of Fact (R.T. 92), he makes this finding:

> "A substantial amount of the time and effort of the attorney for the trustee was spent in performing the duties of the trustee in administering the estate."

We can find no justification at all in the record to support this finding.

In fixing the fee of Appellant, it is apparent that the Referee believed a substantial amount of the time and effort of Appellant, as attorney for the trustee, was spent in performing duties of the trustee.

A trustee best knows what services he needs to have performed by his attorney. Appellant, as the trustee's attorney, was in a better position to know that the services she performed were proper services for the trustee to require. The results obtained demonstrate that the trustee should be complimented, rather than censured, for the attorney he selected and for the amount of time and effort put forth by his attorney. Perhaps the trustee, inexperienced as he was, lacked the capabilities and this necessitated his assigning the duties to his attorney.

The Referee appears to believe that a trustee himself is obligated to collect accounts receivable and to devote such of his time and effort thereto as may be necessary. That such is not the duty of a trustee seems clear, because of the limited commissions that may be paid to him. Were a trustee to rent office space, hire clerical employees, incur stenographic expense and telephone expense to collect accounts receivable, this conduct would be frowned upon and in all probability disapproved by any Referee in charge of any bankruptcy estate. Likewise, on a time basis, an attorney for a trustee ought not, herself, to pursue the collection of accounts receivable on a time basis. A trustee and an attorney for a trustee should pursue the methods of collecting accounts receivable that are pursued in the business world. It is the time-honored method of collecting accounts receivable that a commission be paid to the collector; and if no collections, no pay. One could not justify an attorney for the trustee clocking time in efforts to col-

lect accounts receivable and expecting a fee to be fixed on a time basis.

Since the attorney for the trustee, acting in his behalf, followed the established, generally-accepted and approved method of collecting the accounts receivable of the bankrupt, Appellant should be paid for the very-fine results obtained in keeping with the fees and commissions customarily paid on the gross amounts collected.

There was no reason, in this case, for the attorney for the trustee to keep the time devoted by those in her collection department pursuing and effecting collections. She should be complimented, rather than criticized, because no one can gainsay that collecting more than twice the amount that bankrupt believed his accounts receivable were worth was not a good job, nor can anyone say that collecting three and one-half times the amount the Referee was originally disposed to approve a sale of the accounts receivable for does not show, on the part of the attorney for the trustee, the kind of results for which a reasonable fee should be fixed, not a parsimonious amount.

CONCLUSION

In conclusion, we ask: Is it not common knowledge that an experienced attorney for a trustee in bankruptcy, in most instances, is the one who is responsible for a successful operation of a business and for the sale of a business as a going concern and for the collecting and reducing of the assets of the bankrupt to money? Is it not expected that an experienced attorney for any trustee, but especially an inexperienced trustee, will perform such services? Is it not reasonable, here, to conclude that the successful operation of the business, the successful sale of the physical assets as a going concern, the smooth and successful administration of the estate in bankruptcy, and the success in the collection of accounts receivable must be credited to Appellant? It goes without dispute that Appellant, alone, must be credited with getting 4% interest on the funds of the estate deposited into the depository bank.

It is submitted, upon a fair consideration of this case, that the allowance of only $8,000.00 as a fee is so low as to amount to an abuse of discretion.

It is further respectfully submitted that the question of a reasonable fee should be referred back to the Referee for further consideration and the fixing of a reasonable fee, with the applicable law considered, in the light of the facts of the case; or, in the alternative, that this Court, upon the evidence before it, should direct the allowance to Appellant of the fee of $30,000.00 sought, or such an amount in ex-

cess of the $8,000.00 allowed and the $30,000.00 sought as this Court in its wisdom may deem to be a reasonable fee.

Dated, Phoenix, Arizona,
December 6, 1967.

Respectfully submitted,
STOCKTON & HING,
By HENDERSON STOCKTON,
Attorneys for Appellant
Beverly J. McConnell.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HENDERSON STOCKTON.

No. 22,188-A

United States Court of Appeals

For the Ninth Circuit

In the Matter of
E. W. REYNOLDS COMPANY,
Bankrupt.

BEVERLY MCCONNELL, and OSCAR STROBEL, Trustee of the Estate of E. W. Reynolds Company,
Appellants,
vs.
ESTATE OF W. H. BUTLER, Deceased, CERTAIN DEBENTURE HOLDERS,
Appellees.

On Appeal from the United States District Court for the District of Arizona

BRIEF FOR APPELLANT, OSCAR STROBEL, TRUSTEE OF THE ESTATE OF E. W. REYNOLDS COMPANY, BANKRUPT

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

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BRIEF FOR APPELLANT, OSCAR STROBEL, TRUSTEE OF THE ESTATE OF E. W. REYNOLDS COMPANY, BANKRUPT

JURISDICTIONAL STATEMENT

This is an appeal by Oscar Strobel, Trustee of the Estate of E. W. Reynolds Company, a Bankrupt, from a judgment of the United States District Court for the District of Arizona, entered in proceedings to review an order of the Referee in Bankruptcy of that

Court. The judgment appealed from was entered on the 26th day of June, 1967.

The District Court had jurisdiction of the review proceedings by virtue of Section 1334 of the Judicial Code, 28 U.S.C. Jurisdiction of this appeal exists under and by virtue of Sections 1291 and 1292 of the Judicial Code, Title 28, U.S.C. and Section 24 of the Bankruptcy Act, Title 11, U.S.C. 47.

Notice of appeal from the judgment of the District Court was filed on the 3rd day of July, 1967, within the time prescribed by law.

STATEMENT OF THE CASE

This proceeding arises out of an involuntary bankruptcy proceeding, filed in the United States District Court for the District of Arizona. Appellant, as Trustee, filed objections to claims of various creditors, including a class or group of claimants referred to by Court and counsel throughout the proceedings as "debenture claimants." The objection to the debenture claims was that, "For all practical and equitable purposes the debenture claimants represent proprietary rather than creditor interests, said debentures having arisen out of a debenture-stock exchange plan, and that, therefore, they are in the nature of claims of stockholders and can neither legally nor equitably share in dividends of this estate until payment in full of true creditors." (Specification of Objection, p. 77.)*

*References in parenthesis are to Record on Appeal.

The Referee in Bankruptcy denied the Trustee's objection and held that such claims should be allowed "on a parity with all other general unsecured claims." (Referee's Finding of Facts, p. 101.)

A petition for review was filed by the Trustee and on filing of the Certificate on Review, objection was made by the Trustee to the insufficiency of the Record certified by the Referee to the District Judge. The objections to the sufficiency of the Record and the petition for review were heard on April 7, 1967. On June 26, 1967, the District Judge entered an order denying the Trustee's objections to the sufficiency of the Record, adopting the Finding of Facts and Conclusions of Law of the Referee, denying the Trustee's objections to the claims and ordered that they should be allowed.

THE FACTS

(Reference to facts hereafter will be limited to facts found in the Record as certified by the Referee to the District Judge. Unfortunately, that Record is not complete. It did not contain a transcript of the evidence presented at the hearing nor summary thereof. It contained rather only a summary of those facts which supported the Referee's findings. In addition, it did not include the claims which were in issue or other claims filed in the estate, although the Referee referred thereto in his Finding of Facts and Conclusions of Law. The amounts, status, and nature of the claims which have been allowed, both

by debenture claimants and true creditors of the estate, are material considerations in this controversy.)

The E. W. Reynolds Company was a California corporation engaged in the wholesale jewelry business. Over the years of its operation a plan existed by which employees could purchase stock in the corporation. In October 1956 there were 1615 shares of stock in the corporation owned by employees, each share having a par value of $100.00. (Finding of Fact I, p. 97, and Ex. #1.) The employees had paid $240.00 per share for the stock, and some employees were also obligated on interest-bearing stock subscription agreements on which they were making payments by application of dividends received from the company. (Referee's Certificate, p. 1.)

Records of the company reflect that at least as far back as 1952 the company had been undergoing financial problems. No dividends were paid to stockholders between 1952 and 1956. (Finding of Fact II, p. 97, and Ex. #1.) As conditions grew worse, the company yielded to pressure brought to bear by substantial creditors and revamped its total operations, including the curtailment of the California business. The employee-stockholders also expressed dissatisfaction in that they were receiving no return on their stock investments and further were unable to make payments on the subscription agreements because of lack of dividends. (Ex. #16.) In October of 1956 the company filed an application with the California Di-

vision of Corporations requesting a permit to issue and sell debentures to these employee-stockholders. (Ex. #1.) The application recited:

> "Many of the employees who purchased stock were paying for the stock and had anticipated paying therefor through the application of dividends towards the purchase price. Also many of said employee-purchasers are not in a financial position to make payment on the purchase price of their stock in the absence of such dividends and interest on such dividends and interest on such obligations has continued to accrue. Applicant is informed, believes, and therefore states that many of such employee-purchasers desire to be released from their obligations to continue paying on the purchase price of shares and from the accruing interest on the balance thereof, and in lieu of shares in applicant such employees desire to have an obligation providing for a definite and known return rather than uncertainties of dividends . . ."

The California Division of Corporations did issue its negotiating permit. (Ex. #6.) Pursuant to the permit the company forwarded its letter of December 28, 1956 (Ex. #16) to the employee-shareholders explaining the plan. The letter reflected the company's financial difficulties and inability to pay dividends. It acknowledged that this had resulted partly from too generous dividends in previous years and "some unprofitable periods of operation in recent years; however, the major cause has been the need for more and more working capital." It also ex-

pressed the financial condition of the company would not permit dividends, "for many years to come." A form of commitment accompanied the letter explaining that for those employees wishing to participate, the corporation would issue debentures having a face value of $100.00, bearing interest at the rate of six per cent (6%) per annum, with the first interest payable on May 31, 1957, and the principal of the debentures to mature serially over a period commencing May 31, 1963, and ending May 31, 1970; that all shareholders wishing to participate could receive two and one-half (2½) debentures for each share of stock held by them. Commitments were received from the employee-stockholders involved, and upon supplemental application to the California Division of Corporations the latter issued its permit to "sell and issue" debentures (Ex. #8) in March of 1957. Debentures with a total face value of $244,800.00 were issued and deposited in escrow with the California Bank. The shares of stock by the employees desiring to participate in the plan were surrendered to the company and cancelled. (Finding of Facts #IV, p. 97, Ex. #10 and Ex. #17.)

We refer the Court to Exhibits #11 and #14 which contain financial statements for the company for the fiscal years ending May 31, 1956, 1957 and 1958. For the convenience of the Court we herewith also submit a chronological summary of the events leading up to the debenture issue, and the ultimate bankruptcy of the company, as reflected by those statements:

May 31, 1956—This is the end of the fiscal period immediately preceding the issuance of the debentures. The company sustained an operating loss of $46,-674.53. The statement also reflects the company contemplates further substantial expenses because of a planned move of its headquarters during the next fiscal period. The statement shows an earned surplus of $1,004,374.30. This is the figure reported to the California Division of Corporations in the application for authority to issue debentures. This figure was glaringly inaccurate, however, because the company had never entered on the books the cost of reacquiring capital stock for approximately the last 9 years.

March 1, 1957—Debentures with total face value of $244,800.00 are issued.

June 1, 1957—This is two months after the debenture issue. Retained earnings are now down to $387,491.45 because the adjusting entry of $969,528.89 has been made on the books to reflect the repurchase of stock since 1947. This does include the debenture issue also.

May 31, 1958—The statement reflects net loss for that year of $972,388.96. This includes the loss resulting from the curtailment of the company's operations. The San Francisco store has been closed completely. Los Angeles is reduced to a division, and the company is in the course of concentrating its total operation in Phoenix, all of these having been contemplated at the close of the 1956 fiscal period. The loss

reduced the earned surplus by this time to a deficit of $584,897.51. All of this occurred within slightly more than one year from the time the debentures are issued.

May 1957 until May 1963—Interest totaling $77,-112.00 (Ex. #10) is paid on the debentures. The first principal payment of $33,700.00 falls due in May 1963. That payment, together with the interest payment of $14,688.00 for that year cannot be paid.

June 3, 1963—Involuntary Petition in Bankruptcy filed by "trade" creditors. Retained earnings as of January 31, 1963, was a deficit of $1,005,984.40. (Ex. #12.) Retained earnings as of July 3, 1963, was a deficit of $1,065,287.19. (Ex. #13.)

Claims of creditors filed and allowed by the Referee include charges preceding the debenture issue. (Ex. #14.) With only nominal exception, all of the debenture claimants herein were original debenture holders. (Ex. #10.)

QUESTIONS PRESENTED

1. Are debentures of a corporation issued in payment of repurchase price of stock of the corporation "provable debts" within the meaning of the Bankruptcy Act, entitling the holders thereof to share in payment of dividends with creditors of the estate?

2. Must payment of dividends to holders of debentures issued by a corporation in payment of repurchase price of that corporation's stock be sub-

ordinated to payment of creditors where the issuing corporation was insolvent or rendered insolvent by virtue of their issue, or, where the corporation is insolvent at the time the payment is to be made, or, where there are insufficient funds or assets with which to pay both the debentures and creditors of the corporation?

SPECIFICATION OF ERRORS

1. The District Court (and the Referee in Bankruptcy) erred in holding that the debentures of the E. W. Reynolds Company issued to evidence the purchase price due for the stock repurchased by the corporation were provable debts within the meaning of the Bankruptcy Act entitling the holders thereof to share in dividends in the estate.

2. The District Court (and the Referee in Bankruptcy) erred in finding that claims upon debentures issued by the bankrupt corporation, evidencing the repurchase price of its own stock, should not be subordinated to the payment of creditors of the estate, where the issuing corporation was in financial distress at the time of the issuance, the debenture claimants were aware of such financial distress at the time they agreed to exchange their stock for the debentures, where both creditors existing at the time of the debenture issue and future creditors were factually prejudiced by the issuance, where there are insufficient funds or assets with which to pay the debentures at the time the payment therefor became

due, and where there is factually no surplus or retained earnings at such time.

3. The District Court (and the Referee in Bankruptcy) erred in finding:

(a) That the employee-stockholders had no reason to believe that the E. W. Reynolds Company was insolvent in October of 1956. (Finding of Fact IX.) The Court should have found that the employee-stockholders were well aware of the financial distress, in that they had received no dividends for the preceding years, and that they were expressly advised of the financial problems of the company and that there would be no dividends for "many years to come." (Ex. 16.)

(b) That there was no evidence that any claims of other general unsecured creditors were created prior to May of 1957. (Finding of Fact XIII.) The Court should have found that the claims of creditors had been filed in the estate and allowed which were for obligations incurred prior to March of 1957.

(c) That the insolvency and the bankruptcy of the corporation were attributable to causes other than that of the creation of the debenture obligation. (Finding of Fact XI.) The Court should have found that the issuance of the debentures was a substantial, if not the ultimate, cause of the filing of the Involuntary Petition in Bankruptcy by the trade creditors, in that the inability of the corporation to pay the first

principal payment due on the debentures in May of 1963 occasioned the filing of the Involuntary Petition in Bankruptcy in June of 1963.

(d) That the capitalization of the company at the time of the debenture issue was adequate and not nominal. (Finding of Fact VIII.) The Court should have found that the capitalization of the company was inadequate; that it was the cause of the revamping of the company's operation and curtailment of its California operation, as well as the withholding of dividends to stockholders for the preceding four-year period; and that although a surplus is reflected on the balance sheet at the time of the issuance of the debentures, the entry is inaccurate, failing to reflect the substantial adjustments to surplus for transactions which had occurred in the previous nine-year period; in addition, that there were conditions then in existence, which, upon culmination, would severely affect the financial condition of the company; that if the company was not insolvent at that time, its solvency was doubtful, and dependent upon conditions then in existence, which ultimately did result in insolvency.

SUMMARY OF ARGUMENT

The Trustee's objections to the claims of the debenture holders is two-fold: first, that these claims do not represent "provable debts" within the meaning

of the Bankruptcy Act; and second, that even if they are "provable debts" equity requires that they be subordinated to payment of other claims. The distinction between disallowance and subordination of claims in bankruptcy is succinctly stated by *Herzog & Zweibel,* in their treatise "The Equitable Subordination of Claims in Bankruptcy," 15 Vanderbilt Law Review 83, pp. 85-87:

> "Before launching into a discussion of the nature, cause and effect of equitable subordination some mention should be made of the distinction between outright disallowance of a claim and the subordination thereof to the claims of others. There seems to be an inadvertent confusion of the concepts of disallowance of the claim and postponement or subordination of it . . .
>
> "Disallowance of a claim negates its validity and existence completely and ousts the claimant from creditor status for all purposes. The claim should be rejected and disallowed, it seems to us, when it has no basis in fact or law, is nonexistent or is illegal. Equitable jurisdiction should not be exercised when there is a full, adequate and complete remedy at law. Subordination should be ordered when the claimant is undeniably a creditor, but for reasons of equity should be relegated to a rank inferior to that of general creditors.
>
> "The jurisdiction to disallow claims on legal grounds is derived directly from the act. Only in subordinating or postponing claims does the court exercise its inherent equitable powers. In all these cases the court proclaims itself a court of equity with the power to do equity—but relief

in equity is remedial and not penal. Disallowance of a valid legal claim because of misconduct obnoxious to a court of equity is certainly penal in nature. If under the cardinal principles of equity a creditor is not entitled to share ratably with other creditors, then it seems clear that the proper remedial relief is postponement of payment to him until all others have been paid in full."

ARGUMENT

I.

DEBENTURES ISSUED TO EVIDENCE SUMS DUE BY A CORPORATION FOR REPURCHASE OF ITS OWN STOCK ARE NOT "DEBTS" ENTITLING THE HOLDERS THEREOF TO SHARE DIVIDENDS IN BANKRUPTCY WITH THE CORPORATION'S CREDITORS.

Section 63 of the Bankruptcy Act, Title 11, Chap. 7, Sec. 103, provides "debts of the bankrupt may be proved and allowed against the estate . . ." Filing of a claim, however, does not automatically entitle the claimant to share in dividends. Section 47(8) of the Act, Title 11, Chap. 5, Sec. 75, makes it incumbent upon the Trustee to "examine all proofs of claim and object to the allowance of such claims as may be improper . . ." It is therefore axiomatic that claims which are not "debts" of the bankrupt are not "provable" and cannot be allowed. Obviously, a claim filed by a stockholder of a bankrupt corporation for repayment of money invested in the company, and evidenced by a stock certificate is not a "provable debt" nor "allowable claim." That the stock certificate

may have been exchanged for a note, a debenture, or a contract to repurchase, does not change the nature of the claim. The Court shall, and must, look beyond the form of the claim, to determine the true nature of the transaction. *Herzog & Zweibel,* supra, at p. 93, makes this clear:

> "The so-called capital contribution cases have invariably been treated as a sub-classification within the general sphere of equitable subordination claims. In these cases, an alleged debt is transformed by the Bankruptcy Court into what it deems to be the essential nature of the transaction, to wit: A capital contribution or other proprietary interest.
>
> Several courts relying on Pepper v. Litton have failed to see that these cases actually turn upon the existence or non-existence of the debt and not upon the question of whether the courts will subordinate the claims.
>
> Actually, however, our perspective will be sharpened if we focus on the sole question involved here, that is whether the claim is as a matter of substantial economic and legal reality and indebtedness or whether it is proprietary interest. *Once the judicial investigation has determined that the claim is not in fact a debt but is a proprietary interest, subordination follows as a matter of course,* for the essential nature of a capital interest is a fund contributed to meet the obligations of a business which is to be repaid only after all other obligations have been satisfied." (Emphasis supplied by the writer.)

The debenture claims are "as a matter of substan-
tial economic and legal reality" claims for repayment
of capital or proprietary investments. The debenture-stock exchange plan was nothing more than an agreement by which the corporation agreed to repurchase its own stock, the purchase price being evidenced by the debenture certificates (promissory notes). The volume of cases denying claims of stockholders in bankruptcy on just such agreements is overwhelming. In 9 A.L.R. 1296-1298, the rule is summarized:

> "Apparently as an outgrowth of the trust fund doctrine, it is consistently held that where a stockholder sells or agrees to sell its stock to the corporation and the corporation is thereafter adjudicated a bankrupt, the stockholder is not entitled to prove his claim for the price or on the contract against the estate in competition with creditors, for it is entitled to compensation only in case a surplus remains after all creditors have been paid." (See also *Hamor v. Taylor-Rice Eng. Co.*, 84 F. 392; *Re: S. P. Smith Lumber Company*, 132 F. 618; *Graselli Chemical Co. v. Aetna Explosives Company*, 258 F. 66; *Re: Brueck & W. Company*, 258 F. 69; *Re: O'Gara & McGuire*, 259 F. 935; *Ohlmstead v. Vance & J. Company*, 63 N.E. 634; *Clark & E. C. Clark Mach. Co.*, 115 N.W. 416; *Inland Gas Corporation*, 92 F.Supp. 810; *In Re Semolino Macaroni Company*, 109 F.Supp. 453.) (See also: 3 *Collier on Bankruptcy*, 1781; annot. in 47 A.L.R. 2d 758.)

Very definite rules govern the repurchase by a corporation of its own stock:

"The majority of the American courts have taken the view that a solvent corporation may lawfully purchase and hold its own stock without express authority in the absence of express instructions, provided it acts in good faith and without prejudice to rights of creditors and has a surplus with which to make the purchase." (*Fletcher on Corporations,* Vol. 6A, No. 2848.)

The existence of surplus is essential. This rule has also been expressly codified in both Arizona and California. (West's California Annotated Codes, Corporations No. 1705-07; Arizona Revised Statutes, 10-196.) (*Cutter Labs., Inc. v. Twinning,* 34 California Reports 317, 221 C.A. 2d 302; *Tiedje v. Aluminum Taper Mill,* 296 Pac.2d 554 (Calif.).)

Collier on Bankruptcy, Vol. 3, 1781-92, states:

"Unless forbidden by the laws of the state of incorporation, or by its own charter or by-laws, a corporation may (according to the view prevailing in this country, as distinguished from the English doctrine) agree to purchase or repurchase its own stock, and no creditor may object, provided that the corporation at the time when the agreement was made was solvent, and that it pays the purchase price out of its surplus. This latter requirement is important and is the gist of the trustee's defense in bankruptcy liquidation. Notwithstanding the validity of an agreement to purchase or repurchase the enforceability of such an agreement is always conditioned upon availability of a surplus." (Accord in *Re: Tichenor-Grand Co.,* 203 F. 720; *Boggs v. Fleming,* 66 F.2d 859; *Matter of Atlantic Printing Com-*

pany, 60 F.2d 553; *Matter of Penfield Distilling Company,* 131 F.2d 694.)

The validity of the agreement by which the E. W. Reynolds Company agreed to issue debentures for surrender of its stock is therefore dependent upon a finding that the company was solvent at the time of the agreement.

Enforceability (as opposed to validity) of the agreement is further dependent on a finding that there now exists a surplus from which payment can be made.

The financial statements of bankrupt do not permit a finding that it was solvent in March of 1957. They indicate, rather, that the company was then, and had been for sometime, in dire financial condition—that it was reorganizing its entire operation in an attempt to maintain its operation, and that the condition was obvious to everyone, including its employee-stockholders. And, of course, there is no factual dispute that the company was insolvent at the time the first payment of principal on the debentures fell due, and that it is insolvent now.

The rationale of the rule prohibiting allowance of the debenture claims is well stated in *Re: Atlantic Printing Co.,* 60 F.2d at page 554:

> "Therefore, while it is proper for a solvent corporation to contract to purchase its own stock, the right of a stockholder to enforce the contract is conditioned upon the ability of the corporation to make payment without infringing upon the

protected rights of the other stockholders and creditors. This point arises in Re: Fechheimer. Fishel Company, 212 F. 357, 363, and the court said: 'If a stockholder sells his stock to a corporation which issued it, he sells it at his peril and assumes the risk of a confirmation of the transaction without encroachment upon the funds which belong to the corporation in trust for the payment of its creditors.'

Thus, the solvency of the corporation at the date of the inception of the contract is not determinative of its enforceability. Even though solvent at that time, the contract cannot be performed if performance would imperil those assets on which the creditors have a superior lien. Keith v. Kilmer, 261 F. 733, 9 A.L.R. 1287. In Re: Fechheimer. Fishel Company, *supra* . . .

To allow the present claim would be to repudiate a long-recognized doctrine that capital stock constitutes a trust fund for the benefit of the corporate creditors. Handley v. Stutz, 139 U.S. 417, 11 S.Ct. 530, 35 L.Ed. 227; Upton v. Tribilcock, 91 U.S. 45, 23 L.Ed. 203; Sawyer v. Hoag, 17 Wall. 610, 21 L.Ed. 731. Stockholders are conclusively presumed to know of the trust character of this fund and that all dealings in respect thereto are subject to whatever equities are attached to the fund. To enforce performance of this contract would have the further effect of transforming a stockholder into a creditor and would permit him to share equally and in competition with the other creditors. It is already well established that a shareholder is not a corporate creditor. Warren v. King, 108 U.S. 389, 2 S.Ct. 789, 27 L.Ed. 769; and he does not by virtue of

> the contract to repurchase stock cease to be a stockholder and become a creditor." (*Hazel Atlas Glass Company v. Van Dyke and Reeves,* 8 F.2d 716; *Keith v. Kilmer,* 261 F. 733; *Mathews Bros. v. Pullen,* 286 F. 827.)

See also the Fifth Circuit holding in *Robinson v. Wangerman,* 75 F.2d 757.

II.

CLAIMS OF STOCKHOLDERS WHO HAVE EXCHANGED THEIR STOCK FOR DEBENTURES MUST BE SUBORDINATED IN BANKRUPTCY TO CLAIMS OF CORPORATE CREDITORS.

The equitable powers of the Bankruptcy Courts to subordinate claims is not disputed, and there are more than sufficient reasons here why the debenture claims must be subordinated to payment of other claims allowed in the estate. The debenture claimants originally advanced money purely as an investment, whereas trade creditors advanced merchandise and other property of value, with the full expectation of payment in full. The debenture holders did not contemplate withdrawal of their investment, at least until creditors had been paid. Subordination is nothing other than what they originally agreed upon. They should not be permitted to change their position to the detriment of the corporate creditors. While the motives of the debenture claimants may have been very honorable, their election to convert their holdings to debenture certificates has also worked to their benefit—they have already recovered nearly

one-third (1/3) of their original investment by the interest payments made to them. They were fully aware of the company's financial distress at the time of the agreement, and whether they kept their stock, or exchanged it for debentures, they realized that liquidation of their investment was contingent upon the company weathering the financial storm. They merely substituted an attempt to recover their investment plus approximately a one-third (1/3) realization thereof for the uncertainties of dividends and the possible loss of their total investment. The withdrawal of funds to make the interest payments has, of course, only aggravated the company's problems, decreasing already short operating capital.

CONCLUSION

The claims of the debenture holders are nothing more than the claims of stockholders for payment of funds they invested in the company. They cannot be allowed, when the corporation is insolvent, and there are insufficient funds to pay creditors.

In addition, the debentures themselves are unenforceable under the laws of both Arizona and California, where the transactions occurred. Had suit been filed against the corporation to compel payment, without the intervention of bankruptcy, the absence of surplus with which to make payment would have been an absolute defense. The Involuntary Petition in Bankruptcy was filed just for the purpose of

avoiding such litigation or the possible withdrawal of the company's assets.

These claims cannot, therefore, either legally or equitably, share in the distribution of assets of the estate, and we respectfully request that the judgment of the District Court be reversed, that the debenture claims be disallowed, or wholly subordinated to payment of claims that have been properly allowed in the estate.

Dated, Phoenix, Arizona,
December 6, 1967.

Respectfully submitted,
BEVERLY J. MCCONNELL,
Attorney for Appellant,
Oscar Strobel.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

BEVERLY J. MCCONNELL,
Attorney for Appellant,
Oscar Strobel.

No. 22,188-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

E. W. Reynolds Company,

Bankrupt.

Beverly McConnell, and Oscar Strobel, Trustee of the Estate of E. W. Reynolds Company,

Appellants,

vs.

Estate of W. H. Butler, Deceased, Certain Debenture Holders,

Appellees.

On Appeal From the United States District Court for the District of Arizona.

BRIEF FOR CERTAIN DEBENTURE HOLDERS, APPELLEES.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

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BRIEF FOR CERTAIN DEBENTURE HOLDERS; APPELLEES.

Jurisdictional Statement.

This is an appeal by Oscar Strobel, Trustee of the Estate of E. W. Reynolds Company, a Bankrupt, from a judgment of the United States District Court for the District of Arizona, entered in proceedings to review an order of the Referee in Bankruptcy of that Court.

The District Court had jurisdiction of the review proceedings by virtue of Section 1334 of the Judicial

Code, 28 U.S.C. Jurisdiction over an appeal therefrom exists in the above-entitled Court under and by virtue of Sections 1291 and 1292 of the Judicial Code, Title 28, U.S.C., and Section 24 of the Bankruptcy Act, Title 11, U.S.C. 47.

Statement of the Case.

In the said bankruptcy proceedings, the appellant trustee in bankruptcy filed objections to the creditors' claims of certain creditors, and for grounds of objection as to all of the creditors who are appellees herein, identically alleged as follows: "Allowance of the following claims on a par with the claims of other creditors herein is objected to, and your trustee respectfully requests that their allowance and payment of any dividends thereon be subordinated to payments of dividends to other claims of general unsecured creditors herein." Thereafter, said trustee filed a document entitled "Specification of Nature of Trustee's Objection to Debenture Claims", relating to the claims of the appellees herein. [Clerk's Record, p. 77.]

Said matter came on regularly for hearing before the Referee in charge of said bankruptcy. After a trial consuming a full day's time, in which oral and documentary evidence was introduced and the matter fully argued, the case was submitted upon written memoranda to be filed. After this was done, the Referee made his written Findings of Fact and Conclusions of Law. Based thereon, he entered an Order overruling said objections and ordering said claims to be allowed as filed as general unsecured claims on a parity with all other general unsecured creditors' claims in the proceedings. [Clerk's Record, p. 101.]

The appellant trustee filed with the District Court a petition to review said Referee's Order. The appellant trustee failed to request or arrange for the preparation or transmittal of any reporter's transcript, and, indeed, made no request nor arrangements for the transmittal to the United States District Court of any of the documentary exhibits which had been introduced into evidence. The same accordingly were not before the District Court on the review.

The Referee prepared his Certificate on Review, and filed the same on March 17, 1967. Notice of filing said Certificate on Review was filed on the same date and on said date served upon the appellant trustee.

Said matter came on for hearing before the United States District Court on Friday, April 7, 1967. Two days before that time, namely, on April 5, 1967, appellant trustee mailed to appellees and other interested parties "Objections to Referee's Certificate on Review and Request for Amendment Thereto", and filed the same with the District Court. For the first time therein, appellant trustee requested "that the Referee be by order of this Court required to certify a transcript of the evidence or a summary thereof." No funds or financial arrangements were ever made or offered with respect to said reporter's transcript, and, of course, appellant had allowed only one day for the Referee to prepare a further summary of the lengthy hearing assuming that the Certificate itself were not sufficient for this purpose. As a result, no transcript or summary were before the District Court on the review other than the Referee's Certificate on Review itself, which did contain a summary therein.

No motion or request for a continuance of the hearing set for April 7, 1967, was made by appellant trustee at any time.

Said matter was therefore heard by the District Court on April 7, 1967, and on May 2, 1967, the said Court entered its Order bearing date of April 27, 1967, that the Objections to the Referee's Certificate on Revew were overruled, and that the Referee's Findings of Fact, Conclusions of Law, and Orders appealed from were sustained.

The form of said Judgment was thereafter amended, at appellant's request, and entered as amended, on June 26, 1967. Notice of appeal therefrom was filed on July 3, 1967.

The Facts.

It has been held that where, as here, the Certificate of the Referee in Bankruptcy did not contain a summary of evidence, the Findings of the Referee are conclusive unless wrong on their face. *In re Runnymede Finance Co., Inc.* (C.C.A. 9th), 64 F. 2d 169, accord, *In re Burntside Lodge, Inc.,* 7 F. Supp. 785.

Thus, it is submitted that the facts set forth in the Referee's Findings of Fact necessarily set forth all of the facts upon the basis of which the District Court properly ruled, and which are available for consideration here.

It is to be noted, however, that the appellant's brief devotes considerable length to setting forth appellant's version of "The Facts". This version of the facts not only was not supported by the evidence before the Referee, but as above mentioned, was not brought by appellant before the District Court previous-

y other than as above described, and the introduction of facts at this stage on this appeal as thus attempted, t is submitted, is not appropriate before this Court.

However, in the event that for any reason the Court leems it appropriate to take up the factual matters as lescribed in appellant's brief, appellees hereby submit he following as more fully and accurately setting forth he facts and history involved:

The bankrupt, E. W. Reynolds Company was orignally founded prior to the turn of the century by E. W. Reynolds. Mr. Reynolds started out as a supplier of watch parts and repair materials to watchmakers. The business was incorporated as E. W. Reynolds Company in 1905, and gradually expanded its operations into supplying and distributing watches, as well as watch parts, silverware, jewelry and, subsequent to World War II, small household appliances.

The Estate of Walter H. Butler, Deceased, is the largest single creditor of the above-named bankrupt, and Gladys Reynolds Butler is the Executrix of the Estate. Mrs. Butler is the widow of the decedent and one of the daughters of the company's original founder, E. W. Reynolds.

The business prospered and expanded both under Mr. Reynolds during his lifetime, and later under the direction of his son-in-law, the said Walter H. Butler.

The prosperity and expansion of the business brought its own problems. Its increased volume of sales required larger inventories and resulted in greater amounts of outstanding accounts receivable. The company secured the necessary capital to finance its increased inventories and added accounts receivable by

large bank borrowings. During the early and middle 1950's the company's need for working capital was so great that its bank loans went well in excess of $1,000,000. This high was reached during its peak season, but even during its slack season the company found it difficult to get its bank loans below $500,000. This state of affairs brought its bank under criticism from federal bank examiners who took the position that this loan, at least to the lowest amount outstanding at any time during the year, constituted a permanent capital loan. Such classification of a loan would require the bank to place additional amounts on reserve. The company's bankers then advised the company that it would have to change its dividend policy, retain its earnings, or secure other sources of permanent capital investment, so that it would only use bank loans for short term peak season needs.

A temporary expedient to solve the immediate problems of the bank was developed. The regular bank used by the company was paid off by simply going to another bank and borrowing the required funds. This back and forth device was recognized to be only a temporary solution and retention of earnings, possible reductions in inventory, and tighter credit policies would have to be employed in order to bring the company's operations within its available capital.

During the early 1950's a good portion of the increased volume of business came from the sale of small appliances. However, these appliances were relatively large items from the standpoint of bulk, compared to the dollar volume of sales, and the profit margins were also low by reason of sharp competition. The company's operations had been conducted for many years in

downtown Los Angeles on 5th Street between Broadway and Hill, and the increased appliance business required the renting of a warehouse in the City of Vernon. This separation of facilities increased overhead costs, and during 1955 and 1956 plans were made and put into effect whereby Mr. Butler and his two sons provided the necessary capital to finance the construction of a combination of office, showroom, and warehouse, in an area now known as the City of Commerce. It was expected that by consolidating all of the operations, administrative, sales and warehousing, efficiency and savings would be realized. Part of this program was the result of recommendations made by a management consultant organization which was paid a fee of $22,724.41 during the fiscal year ending May 31, 1956, which constituted almost half of the net operating loss for that year. Other actions taken with respect to reduction in inventory and reorganization which occurred during 1956 contributed to that year's operating loss. However, these losses were anticipated, as it was expected a loss would be incurred with the moving expenses, the disruption in regular activity and certain reduction in inventory and other reorganization efforts.

As part of this reorganization plan, a policy that no dividends would be paid was adopted, and the adoption of this policy gave rise to the debenture exchange program which is the subject of the present appeal.

In 1947 the company had offered to sell some of its stock to employees on a stock purchase plan. Many of the employees, and most of the key employees, took up the offer and purchased stock, almost all by means of a small downpayment with the balance represented by a note secured by a pledge of the stock. It was ex-

pected that the dividends paid on the stock would take care of all or substantially all of their installment payment obligations as the company had a good record of earnings and a liberal dividend policy. Other principal stockholders, particularly members of the Butler family, had established standards of living based upon this generous dividend policy.

Thus, the increase in volume of business, the increase in costs of doing business, and the lower profit margins on a major segment of the sales volume all combined to put the squeeze on profits and increase the need for more working capital.

This was the situation facing the company's management and its bankers, with the result that a policy was established that no dividends would be paid until the company's working capital was built up out of profits to the point that bank loans would be needed only during the peak season to finance the added inventory needed for and the added receivables resulting from the Christmas season business.

It was realized that the establishment of the dividend policy would have a major impact on the many stockholder-employees who were depending upon dividends on the stock as the source of funds to meet their stock purchase plan payments. There were others whose savings were invested in the company's stock and who relied on dividends for part of their living expenses. All the key employees of the company, department heads, top salesmen, and the top echelon of administrative personnel were involved in the stock purchase plan and the company management were concerned about the many adverse affects the no dividend policy would have.

The two major effects on these stockholder-employees were, one, they would most likely have to default on their stock purchase contracts, and, two, they would be getting no return on their invested savings. A collateral problem existed because the company had a policy of purchasing the stock of deceased employees and as a part of the capital building program, it was no longer going to repurchase any stock from deceased employees. The company's stock, other than that owned by employees, was closely held by members of the family and had no market, thus a deceased employee's spouse would have no way of either raising money by a sale of the stock or getting any returns from the investment for an indefinite period in the future.

All of the considerations prompted the company's management to explore means of accommodating to the needs and desires of its many and important employees to maintain their loyalty and support and provide incentive for the future as well.

The device chosen to solve the problem was debentures. Debentures were capable of providing a given return per annum. Their value was fixed, and as evidences of indebtedness they had definite market value and were saleable. An additional attractive feature was that the interest paid on the debentures was a deductible expense for corporate income tax purposes.

As debentures appeared to provide the solution to the many problems which would arise between the company and its employee-stockholders upon the adoption of a no-dividend-policy, the company's management proposed a program of an exchange of stock for debentures coupled with a cancellation of all outstanding stock purchase commitments.

This exchange privilege was offered only to employee-stockholders and not to any of the corporate officers or members of the family group constituting the top management of the company.

There were 32 of these employee-stockholders and the largest single holding was 300 shares with a net equity of $43,470.00. The next largest equity was $25,000, and there were only six employees with equities between $25,000 and $10,000. The remaining 25 (out of 32) had equities of less than $10,000.

[Exhibit B to Supplement to Application filed October 31, 1956.]

The debentures to be issued were set up in series with none maturing before 1963.

The debenture-exchange program solved all of the company's problems with its employee-stockholders in such a way as to keep and maintain their loyalty and interest in the company and its future and forestall any complaint or feelings of animosity by these employees toward the company. The debentures were marketable and would give a current return at a reasonable rate on savings.

The company also would benefit as the interest paid would be a tax deductible expense, and though the debentures had maturity dates, they were far enough in the future to give the company an opportunity to improve its capital position by the retention of all of its earnings in the interim. Because of the marketability of the debentures, the company didn't have to concern itself with its responsibility to cash in any stock of deceased employees.

The annual cost of carrying this debenture issue was less than $15,000 per year (6% of the total amount of

debentures issued—$244,800, or $14,668) and after corporate income taxes the cost would be only about one-half of that amount. Year-end employee bonuses were much more than the cost of carrying the entire debenture issue.

Actually the debenture issue was a relatively small part of the entire reorganization plan. It was fully discussed and fully approved by the company's bankers who continued to renew loans in amounts between $500,000 and $1,000,000.

At this same time it was decided that a consolidation of the company's warehousing, showroom and office facilities would reduce the costs of operation. Mr. Walter H. Butler and his two sons, all in the top management group of the company and principal shareholders, purchased land and built a building in what is now the City of Commerce, specially designed with executive and administration offices, diamond vaults, air conditioned showrooms, and a warehouse area to house all the company's operations under one roof.

The plan of reorganization considered was adopted in 1956, as evidenced by the payment of $22,724.41 for management consultant fees and by the application to the California Commissioner of Corporations for the debenture exchange plan and the moving to the new place of business.

This was certainly not the course of action taken by a company on the verge of bankruptcy or insolvency.

It should be noted that as of May 31, 1956, the net worth or stockholders' equity was over two million dollars ($2,124,559.30). [August 31, 1956 Financial Statement.]

In spite of reverses, the stockholders equity at the end of the 1957 fiscal year was $1,754,046.00, and even at the end of the 1958 fiscal year the stockholders' equity was $807,381.

Unfortunately, this old line distributor was caught up in new merchandising methods in its field. Discount houses, and large merchandisers began buying direct, and on the other end of the line the retail jewelry merchant was expanding his easy credit sales and demanding longer terms from the wholesale distributors.

The discount operators put a squeeze on profits and the company's competitors were extending easy credit terms which had to be matched and this added to the company's need for more working capital. At the same time the company's bankers were tightening on the loans.

In an effort to improve the position of the company, Mr. Butler, the president, who had advanced substantial sums to the company, and his wife, who was also a substantial creditor of the company, agreed to accept preferred stock of the company in exchange for the amounts owed.

Following the completion of this exchange, which occurred during the 1959-1960 fiscal year of the company, the stockholders' equity was still $108,208.20. Indeed, as of January 31, 1961, the stockholders' equity was still $63,168.25; as of January 31, 1962, the stockholders had an equity of $29,148.35.

In continued efforts to accommodate to changing conditions and to continue the enterprise, further retrenchment action was taken. The Los Angeles operation was terminated and the company moved to its

Phoenix branch office, where it hoped to be able to operate at a profitable level.

Unfortunately, these hopes failed to materialize and finally, the company was declared bankrupt in 1963.

Questions Presented.

The only question presented before the bankruptcy trial court and the District Court on review was whether the creditors' claims of the debenture holders should in equity be subordinated in payment to the claims of other unsecured creditors, or whether they should be treated on a parity with them. No question was raised in the pleadings, at the trial, or before the United States District Court Judge as to whether the so-called debenture claims were "provable" in bankruptcy, or "enforceable", and appellees respectfully object to the raising of such additional issues for the first time at the present stage in the proceedings.

Summary of Argument.

The debentures are not proprietary interests; they are debts of the bankrupt. Equitable grounds for subordination of the debenture holders' claims are not present. There was no proof of the existence of any creditors in these proceedings to whose claims the appellees' claims should be subordinated legally or equitably. The Findings of Fact of the Referee should be sustained unless "clearly erroneous".

ARGUMENT.

I.

The Debentures Are Not Proprietary Interests; They Are Creditors' Claims.

The Referee determined that the claims of the debenture holders in fact were debts and were not proprietary interests. As a result, he properly denied the trustee's motion for subordination of their claims.

The Referee's conclusions were supported by a host of material factual criteria. The Findings of Fact numbered VIII, IX, X, XI, XII and XIII compel the conclusion which he reached.

The same in substance determined, first, that the capitalization of E. W. Reynolds Company was adequate and not merely nominal; second, that the employee-stockholders had no reason to believe that E. W. Reynolds Company was insolvent; third, that at the time of the agreement in October 1956, the employer-stockholders did not have nor possess any degree of control over management or the fiscal policies of E. W. Reynolds Company (and *a fortiori* had none once they become debenture holders thereafter); fourth, that the financial difficulties of E. W. Reynolds Company were not attributable to the creation of the debenture obligations; fifth, that after the creation of the debenture obligations the holders did not participate in the operation, ownership or management of E. W. Reynolds Company; and sixth, that the trustee had not proved nor did any evidence disclose the existence prior to May of 1957 of any presently outstanding claims of other general unsecured creditors.

Thus, unlike cases where subordination has been ordered, in the case at bar the facts established cumula-

tively that there was no proprietary interest on the part of the debenture holders and, on the contrary, the opposite was true.

> "Where there was nothing to compel a finding that bonds secured by the bankrupt's property must equitably be regarded as having been or as subsequently having become in effect a contribution to capital in favor of general creditors, the bonds could not be subordinated to the claims of general creditors on that theory . . .
>
> "The power of subordination necessarily must be measuredly and not blankly exercised. It must have a sound regard for the distribution results that will be produced to the creditors whose claim is being subordinated as well as to the other creditors. It should not operate to take away anything punitively to which one creditor is justly entitled in view of the liquidation finality and bestow it upon others who in the relevant situation have no fair right to it. It can, therefore, ordinarily go no farther than to level off actual equitable discrepancies on the bankruptcy terrain for which a creditor is responsible to the point where they will not create an unjust disadvantage in claim position and liquidation results."
>
> *In re Kansas City Journal-Post Co.*, 144 F. 2d 791, 795, 800.

With respect to the argument advanced by the appellant, we note that of the six classifications of situations set forth in the article "Equitable Subordination of Claims in Bankruptcy" by Herzog and Zweibil, upon which the appellant relies, only one such classification, namely, "Debt, Proprietary Interest or Capital Contri-

butions cases", is urged as a basis for subordination in the case at bar. We submit that the evidence introduced in the instant case by the trustee fails to establish grounds warranting subordination upon the said basis.

> "These cases actually turn upon the existence or non-existence of a debt, and not upon the question of whether the court will subordinate the claim." *15 Vanderbilt Law Review 93.*
>
> "Unfortunately, some bankruptcy courts have utilized the vague criterion of *Pepper v. Litton* (*i.e.* the 'Rules of Fair Play and Good Conscience') to determine the narrow question of whether the advance is in fact a loan or proprietary interest. A few opinions, however, have attempted to sketch applicable principles. Thus it has been said that it is not sufficient to find that the capitalization was inadequate, but that it must have been 'purely nominal'." 15 *Vanderbilt Law Review* 95; *Brown v. Freedman,* 125 F. 2d 151, 156.

Certainly in the case at bar, the facts fail to disclose that the capitalization at any time was "purely nominal". Even if a less restrictive test were applied, the evidence does not adversely establish any basis upon which the court can make a "factual determination as to whether the corporation has been provided with separate assets adequate to give it at least a reasonable business chance to carry out its asserted functions". 15 *Vanderbilt Law Review* 95. In fact, the evidence wholly supports the position of the debenture holders, for long continued operation was feasible.

Other applicable principles to be applied, according to said authors, include whether the essential nature of an advance is the cause of the eventual insolvency. Op.

Cit., at page 96. "On the other hand, if bankruptcy is attributable to causes other than that the entire life of the company from its inception was an insolvent operation, the loan is more likely to be sustained as such." Op. Cit., 15 *Vanderbilt Law Review* 96; *In re L. M. Alleman Hardware Co.,* 181 Fed. 810, 813.

In the case at bar, the trustee has failed to sustain the burden of proof to establish this criterion.

> "Another factor is time. The longer a corporation functions on its initial capital before controlling stockholders make advances, the greater the likelihood that the advances will be held bona fide loans." 15 *Vanderbilt Law Review* 96; *Arnold v. Phillips,* 117 F. 2d 497.

In the case at bar, the factual situation is not that of controlling stockholders, or even of stockholders who continue to be such at all; on the contrary, the debenture holders herein wholly lost their position as shareholders in the corporation upon relinquishment of their shares many years ago. It is submitted that the trustee failed to sustain his burden of proof on this factor either.

"Active participation in management may be one of a series of cumulative indicia of a proprietary interest." 15 *Vanderbilt Law Review* 98. The facts at hand establish exactly the opposite situation in this case.

The Court of Appeals for the Ninth Circuit was presented with the situation of an advance to a debtor corporation in consideration of an offer by a stockholder of his "net profits" in the development or sale of an oil lease. On these facts the court could find no joint venture, but merely a debtor-creditor relation due

to the absence of proof that the lender had any voice in the management of the venture or that he participated in the work. Accordingly, the court reversed an order of the Referee and of the District Court subordinating the claim, stating that it found "no evidence of any conduct on appellant's part which would make it inequitable for him to share with other creditors, or which estops him from so doing." *In re Pomoc Oil Co.,* 110 F. 2d 210 (9th Cir.)

II.

Appellant Failed to Prove by Clear and Convincing Evidence That Equitable Grounds for Subordination of Appellees' Claims Are Present.

Rather than lightly or automatically invoking subordination, this drastic remedy has been limited by the courts to nullify the effect of fraud that a creditor has committed.

The standard adopted by the U.S. Supreme Court for subordination requires:

> "The violation of rules of fair play and good conscience by the claimant; a breach of the fiduciary standards of conduct which he owes the corporation, its shareholders and creditors." *Pepper v. Litton,* 308 U.S. 311, 84 L.E. 291. "The rule is well summarized in *In re Bowman Hardware & Electric Co.,* 67 F. 790, 792, 794, as follows: 'Before a general creditor's claim against the bankrupt may be disallowed or its status lowered, it must appear that said creditor has been guilty of some act involving moral turpitude or some breach of duty or some misrepresentation whereby other creditors were deceived to their damage'." *Mc Donell v. Sampsell* (CCA 9th), 193 F. 2d 954

In denying subordination and ordering that the creditors' share on an equal basis, the court has declared: "The theme of the Bankruptcy Act is equality of distribution. Sec. 65a; *Moore v. Bay,* 284 U.S. 4; 18 ABR (NS) 675; 52 S. Ct. 3; 76 L. ed. 133. To bring himself outside of that rule, an unsecured creditor carries a burden of showing by clear and convincing evidence that its application to his case so as to deny him priority would work an injustice."

Accordingly, the court required that there be proof of fraud in a transfer as a basis of granting priority over other unsecured creditors, and as a result, such proof being absent, denied the subordination sought as respects certain unsecured claims.

> *Sampsell v. Imperial Paper & Color Corp.,* 313 U.S. 215, 85 L. ed. 1293, 1298.

Similarly, the decision in *Hansenn v. Wingren,* 121 F. 2d 1011, 314 U.S. 683, enunciated and summarized succinctly in a headnote thereof, determined:

> "Where claims of creditors were established in corporate reorganization proceeding and were secured by lien on corporation's assets prior in rank to claims and liens of certain other creditors, and the plan was confirmed and consummated in part, and nearly three years after confirmation the corporation was adjudicated a bankrupt, and corporation's financial position on date of adjudication was substantially different from its position on date of confirmation of plan and creditors could not be placed in status quo, and creditors lost certain valuable rights by accepting plan of reorganization, creditors, were entitled to priority over such other creditors in the bankruptcy proceeding."

By analogy, the debenture holders in the instant case likewise changed their position by accepting issuance of their debentures many years ago; surrendered any authority to participate in the direction and/or control of the corporation involved; the issuance of their debentures was at a time when the corporation had a surplus, and was in actual payment, then and there, for the shares of stock which they surrendered; was entirely under the supervision and direction of the Corporation Commission of the State of California; and there was no fraud or withdrawal of assets occasioned by the resulting change of position above mentioned.

The facts in the case at bar are accordingly clearly distinguishable from the case decided in the year 1919 and relied upon by the trustee, namely, *Keith v. Kilmer,* 261 Fed. 733, and which forms the basis of the annotation in 9 ALR 1287. Contrary to the instant case, in *Keith v. Kilmer* the court pointed out that, "It is entirely clear that the transaction out of which the alleged contract grew was entered into, not for the benefit of the corporation itself, but for the benefit of certain stockholders. In brief, junior and minority shareholders, desired to buy out the senior and majority shareholders; and, having no money with which to buy, the parties agreed, not for the benefit of the corporation, but for the benefit of the trading shareholders, to have the corporation, in form at any rate, agree to buy and pay for a large part of the stock intended thus to pass ultimately from the seniors to the juniors, thus giving them control of the corporation and its offices with the emoluments thereof. The corporation was so-to-speak made an accommodation purchaser for the benefit of certain vending and purchasing shareholders."

Similarly, analysis of each case cited in the annota-ion to said case of *Keith v. Kilmer,* also reveals that here were elements of moral turpitude with respect to he specific transaction involved. Such was not the state of the facts in the case at bar. On the contrary, here it was the corporation which initiated and carried forward the acquisition and immediate cancellation of the shares of stock from the debenture holders, and there is a total absence of evidence, much less the "clear and convincing proof" required in cases of fraud, to establish in any way any unjust enrichment or inequitable conduct on the part of the debenture holders in the case at bar.

III.

There Was No Proof of the Existence of Any Creditors in These Proceedings to Whose Claims the Appellees' Claims Should Be Equitably Subordinated.

The trustee failed to establish at the trial the existence prior to May of 1957 of any claims now outstanding of other general unsecured creditors. [Finding of Fact No. XIII.]

For that matter, there was no proof offered or received in evidence at the trial on the Objections to Appellees' Claims either as to the existence or nature of any creditors' claims other than those of appellees, with the possible exception of the existence of the claims of former principals of the debtor, namely the Estate of W. H. Butler. With regard to the claim of said creditor, said creditor has never urged the subordination of the claims of appellees, although actively participating in the bankruptcy case.

Under the circumstances, where there has not been established the existence of any creditor or class of creditors who equitably are entitled to a priority over the creditors' claims of appellees, an indispensable element necessary for subordination is absent. Certainly, the appellant is in error in asking this court to speculate that there may be in existence claims of other creditors which equitably have greater rights than those of appellees; in fact, such was not proven to be the case. Only where there is clear and convincing evidence that denial of a priority to another creditor would work an injustice to him is subordination appropriate, and this obviously has not been established absent proof of the nature and existence of such other creditors' claim.

> *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 85 L. ed. 1293, 1298;
>
> *Consolidated Music Co. v. Brinkerhoff Piano Co.*, 64 F. 2d 884, 886;
>
> *First Trust Company v. Illinois Central R.R. Co.*, 256 Fed. 830 (aff'd 249 U.S. 615, 63 L. ed. 803, 39 S. Ct. 390, 243 Fed. 450, 252 Fed. 970).

IV.

The Findings of Fact of the Referee Should Be Sustained Unless "Clearly Erroneous."

Where, as here, there is no transcript or summary transmitted on review, the reviewing court must look to the findings of the Referee as conclusive of the facts unless on their very face they appear erroneous.

> "The findings of the Referee were conclusive upon the trial court unless they appear to be wrong on their face." *Matter of Runnymede Finance Co., Inc.* (C.C.A. 9th), 64 F. 2d 169.

In the case at bar, lengthy hearings were held before he Referee, at which witnesses were sworn and testi-ied and whom the Referee had the opportunity to ob-erve, documentary evidence was introduced, counsel ad full opportunity to argue the matter and did so, nd the Referee prepared Proposed Findings of Fact, Conclusions of Law and Order, to which Objections vere lodged by the trustee's counsel. After careful onsideration, the Referee finally made and entered the Findings, Conclusions, and Order on file herein.

It is established beyond question that the Findings of a Referee will not be disturbed on appeal unless "clearly erroneous".

> "Where the basic and undisputed facts are fairly susceptible of diverse inferences requiring different conclusions, the determination made by the trier of fact is conclusive on review unless that finding is 'clearly erroneous'." *Hoppe v. Rittenhouse* (C.C.A. 9th), 279 F. 2d 3, 9.

The foregoing holding of the courts is directly in accord with the applicable Federal Rules of Civil Pro-cedure and with the applicable General Order in Bankruptcy.

> *Rule 52(a) of Federal Rules of Civil Procedure; General Order in Bankruptcy 47.*

Conclusion.

The appellees do not hold "proprietary interests". On the contrary, the debentures which were issued and which form the basis of their claims, were issued for a concurrent consideration, and the transaction was a fully completed and executed one, not an executory agreement. The debentures were negotiable. To a sub-

stantial extent, the present creditor claimants are not those to whom they were initially issued, but are their heirs, successors, assigns, or transferees. There was no fraud in the creation or maintenance of the claims of appellees, and there is no inequity in treating them on a par with other creditors; on the contrary, to do otherwise would result in a gross inequity. Where the debentures, and accordingly cannot be said to have arisen in current cancellation of shares of stock which debenture holders formerly held, where the rights of creditors (if any) arose subsequent to the issuance of the debentures and accordingly cannot be said to have arisen in reliance upon any financial statement or condition whereby there was reliance upon the existence of any capital stock purportedly held by appellees or their predecessors, and where the debentures were issued under the supervision, control, and authorization of appropriate public authorities, it is submitted that the equitable principles necessary for invoking subordination are not present. Accordingly, subordination should be denied, the creditors' claims allowed, and the Order of the District Court and Referee sustained.

Dated at Los Angeles, California, January 31, 1968.

Respectfully submitted,

Huston & Kendrick and
Haskell H. Grodberg,
By Haskell H. Grodberg,
Attorneys for Appellees-Debenture Holders

Certificate of Counsel.

I certify that in connection with the preparation of his brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

HASKELL H. GRODBERG

Nos. 22188 and 22188-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22,188

BEVERLY J. McCONNELL,

Appellant,

vs.

ESTATE OF BUTLER,

Appellee,

and

No. 22,188-A

OSCAR STROBLE, TRUSTEE,

Appellant,

vs.

ESTATE OF BUTLER,

Appellee.

On Appeal From the United States District Court for the District of Arizona.

APPELLEE'S REPLY BRIEF.

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Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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APPELLEE'S REPLY BRIEF.

Introductory Statement.

Beverly J. McConnell, the attorney for the Trustee of the estate of the bankrupt, E. W. Reynolds Company, has been designated as the Appellant by her counsel, and the Estate of Butler has been designated the Appellee in appellate proceedings No. 22,188. While Miss McConnell is the person who claims to be aggrieved by that portion of the order of the Referee in Bankruptcy for allowance of her fees and may be properly

designated as an Appellant, the designation of the Estate of Butler as the sole Appellee in both proceedings is probably legally incorrect and factually in error.

The largest single creditor (total allowed claim $139,-211.26) of the bankrupt's estate is Gladys Reynolds Butler the Executrix of the Estate of Walter H. Butler, Deceased. While Mrs. Butler in her representative capacity was the leading objector to the claims of Miss McConnell, she was by no means the sole objecting creditor, and, therefore, if she in her capacity as Executrix is a proper appellee, she is not the sole appellee in proceedings No. 22,188. The original objections were made for the benefit of all creditors, and this brief is also being filed for and on their behalf in proceedings No. 22,188. Neither Mrs. Butler nor the Estate of Butler is an appellee in proceedings No. 22,188-A, which is the Appeal of the Trustee from the portion of the Referee's order relating to the allowance of the claims of the debenture holders, and as to this matter Mrs. Butler takes no position.

Statement of Issues.

The sole issue involved in proceedings No. 22,188 is whether the Referee abused his discretion in the determination and allowance of fees to the attorney for the Trustee.

In arguing this issue we are faced with not having a complete record on appeal as there is neither a transcript of the testimony of the witnesses nor an agreed statement of facts.

The Certificate of Review filed by the Referee contains a summary of the facts and other portions of the record on appeal shed further light on this issue, how-

ever Appellant's brief contains many statements and assertions without support either in the available record or in the evidence and testimony introduced before the Referee. To effectively reply to such a brief we shall be obliged to state some facts for which there will be no supporting evidence in the record on appeal.

Statement of Facts.

The accompanying brief filed on behalf of the debenture holders in proceedings No. 22,188-A sets forth the history and background of E. W. Reynolds Company and the facts which led finally to its adjudication in bankruptcy.

The corporation was adjudicated a bankrupt and the Receiver was appointed on July 5, 1963. Oscar Stobel was appointed the Receiver, and Appellant, Miss McConnell, became the attorney for the Receiver.

After the adjudication in bankruptcy the business was continued on a very limited basis for a short period of time in an effort to sell it as a going business. There were no buyers for the company as a going business, and the tangible assets of the bankrupt's estate (no realty was involved) were disposed of in two sales, 1) a bulk sale of all of the inventory, and 2) a sale of all of the furniture and fixtures. The firm name and any good will attached to it were sold with the merchandise inventory.

Following these two sales, which took place less than two months after the adjudication in bankruptcy, the sole remaining activity of the Trustee was the collection of accounts receivable. [Referee's Findings of Fact ¶III and ¶V.] The only legal problem of consequence arising during the administration was the issue

which was recently raised as to the status of the creditors' claims based on unpaid debentures issued in 1956 by the bankrupt. [Referee's Cert. of Review, last page, lines 21-23, Clk. Tr. p. 6.]

It appears from the Trustee's accounting that by far the greatest part of the accounts receivable were collected by the end of January, 1965, less than a year and one-half following the beginning of collection activities by the Trustee. It should be pointed out that this year-plus period is not an indication of difficulties in making collections of the accounts receivable. The credit terms extended to the customers of the bankrupt were for very long periods in many instances, some being on the basis of promissory notes of varying periods from six months to fifteen months or more, others on a so-called 6/6 plan where a customer would make purchases for six months and then would have the following six months period to pay off the account. Thus, collection of some accounts or notes would extend over a year or more without any delinquency being involved.

The evidence shows that only 13 lawsuits were filed in efforts to make collections of accounts receivable, 7 in Arizona and 6 in California. Few, if any, of these cases actually went to trial. The total of the demands in the Arizona cases was $7,117.80, of which about $6,958.55 was collected. The total of the demands in the 6 California cases was $16,407.52 of which $1,503.52 has been recovered. Accounts receivable of an unknown face amount were referred to out-of-state collection agencies or collection attorneys, which resulted in collection of a gross amount of about $26,000 of which over $5,000 was paid to the collection agencies or collection attorneys in California.

Some indication of the collection activity can be gained by looking at the lists of accounts receivable attached to the Debtor's Petition. There the accounts were classified and divided into four groups. Group I were accounts on regular terms. This Group numbered about 280 with a total outstanding of $31,559.05, and of this total only about ¼th were delinquent, all the rest current. Group II were those on special or extended terms and numbered slightly under 100. The total outstanding was $94,974.50. Of these all but about ¼th were current. No analysis of the accounts listed in Groups III and IV was made. They were classified as doubtful of collection, and the total outstanding in these two groups was $162,219.35.

During the period of receivership, the principal employees of the company stayed on duty and continued to function under the authority of the Receiver. The transition was thereby made very smoothly and the records maintained in good order, greatly simplifying the transfer to the Receiver's and Trustee's accountant, one William Price.

Thus from the foregoing it is evident that no difficulties were encountered in the handling and administration of the estate or in the liquidation of the tangible assets, and that no special efforts were required in the liquidation of the accounts receivable. It was a routine bankruptcy administration.

ARGUMENT.

Fixing of Attorneys' Fees in Bankruptcy Is Peculiarly Within the Discretion of the Referee, and the Referee's Judgment Will Not Be Set Aside on Appeal Unless Clearly Erroneous.

Generally speaking, a bankruptcy referee's fact findings must be upheld by the Court of Appeals on appeal from a District Court's order confirming a Referee's order, unless they are clearly erroneous. See *Federal Rules of Civil Procedure,* §52(a), 53(e)(2); *General Order in Bankruptcy No. 47,* 11 USCA following §53; *Engelbrecht v. Bowen,* 300 F.2d 891 (9th Cir. 1962); *Farmer Bros. Co. v. Huddle Enterprises, Inc.,* 366 F. 2d 143 (9th Cir. 1966); *Cedar-Comp Materials Co. v. Bumb,* 344 F. 2d 256 (9th Cir. 1965); *Tepper v. Chichester,* 285 F. 2d 309 (9th Cir. 1960); *Hoppe v. Rittenhouse,* 279 F. 2d 3 (9th Cir. 1960).

Moreover, discretionary orders made by a referee will not be reversed in the absence of a clear abuse of discretion. See *In re Sanborn,* 96 Fed. 511; *In re Belknap,* 96 Fed. 614.

And, according to *In re Dole Company,* 244 F. Supp. 751, 754:

> "It is the universal rule that the fixing of attorneys' fees in bankruptcy is peculiarly within the discretion of the referee and the referee's judgment, if sufficiently supported by evidence and free from error of law, ought not to be disturbed unless it is so manifestly inadequate as to constitute an obvious miscarriage of justice. [Citing cases]."

In the Absence of a Transcript of Testimony or an Agreed Statement of Facts as Part of the Record on Appeal, the Summary of Evidence as Contained in the Referee's Certificate Must Be Relied Upon, and Where Such Certificate Contains Sufficient Substantial Evidence to Support the Findings of Fact and Conclusions of Law, the Order of the Referee Must Be Affirmed.

The review on appeal of an order in bankruptcy is restricted to the record. *United States v. Goggin,* 187 F. 2d 530 (1951, C.A. 9th) *Remington On Bankruptcy,* §3441, Vol. 8, page 342 and cases cited.

In *Farmer Bros. Co. v. Huddle Enterprises, Inc.,* 366 F. 2d 143 (9th Cir. 1966) the court stated that since the appellant did not furnish the District Court with a reporter's transcript of the testimony, the Circuit Court must rely upon the contents of the Referee's Certificate. And, since the Certificate On Review in the instant case [Clk. Tr. pp. 1, *et seq.*] contains substantial evidence to support the Referee's findings, the Circuit Court is required to accept the findings of the Referee in bankruptcy.

Comments on Findings and Evidence.

Appellee, while convinced that this court does not have a sufficient record on which to predicate a reversal or modification of the portion of the Referee's order relating to allowance of fees to the attorney for the trustee, desires to point out from the available record that the Referee's order is well supported by his Findings of Fact, by the evidence set forth in his Certificate on Review and by the available record. Comments with respect to the several contentions of Appellant are set forth below under descriptive headings.

Interest Earned.

One of the principal items urged in the Appellant's brief as entitling her to more fees is the item of interest earned on funds in the hands of the Trustee. First, the available record shows that the arrangement for the deposit of the funds of the bankrupt's estate in a savings account was made while Miss McConnell was acting as attorney for the Receiver, before the appointment of the Trustee, and before she became attorney for the Trustee. In Schedule "A" attached to Miss McConnell's Petition Of Attorney For Receiver For Allowance of Compensation, etc. [see Clk. Tr. pp. 72 and 73] she set forth time charge items for preparation of a petition and order authorizing transfer of funds to a savings account and for conferences with the bank and accountant regarding this deposit of funds. Thus, this matter was handled and disposed of before Appellant became the attorney for the Trustee and is not properly an item to be considered here where we are concerned only with her claims for fees as attorney for the Trustee.

Even so, we believe it to be a matter of common knowledge that 4% interest is a common or ordinary rate of interest paid on savings accounts by banks. The fact that $30,000 in interest was earned on money on deposit, rather than being a circumstance or result on which to claim fees for extraordinary services on the part of the attorney, is merely indicative of the long period of delay in the handling and disposition of money which belonged to the creditors and should have been distributed to them. The retention of this large amount of cash in a savings account rather than being a benefit to the creditors was a detriment as it can be safely

asserted that there was not one creditor of the bankrupt who would not have preferred to have had his share of the money and to have put it to use rather than leaving it with the Trustee earning only 4% per annum for the better part of four years.

There is nothing in the record which supports the argument of the Appellant that the interest earned was the result of some extraordinary service on her part or came about because of her standing, prestige or ability. On the contrary, the record shows otherwise. Furthermore, the record fails to show that Miss McConnell rendered any services in this regard while acting as attorney for the Trustee.

Sales of Assets.

The Appellant also seeks to take special credit for the amounts received on the sales of the merchandise inventory and the furniture and fixtures by comparing the sale prices with the estimated values placed on these items by the bankrupt and by an appraiser. Suffice it to say that the merchandise inventory and the furniture and fixtures were sold as the result of bids in open court in two sales, both within 30 days after the appointment of the Trustee. The fortuitous circumstances which resulted in sales for amounts in excess of the estimated values can hardly form the basis for a claim for legal fees. There is nothing in the record to indicate that the amounts received, even though in excess of the estimated values placed on these items by the bankrupt and the appraiser, were greater than the market value of the property being sold, or, that the activities of the Appellant were responsible for the amounts received on these sales. Assertions to this af-

fect have and will be made by Appellant as intimations along these lines have already been made in the Opening Brief, however neither the record nor the evidence will support such assertions.

The failure of E. W. Reynolds Company, which was the oldest and largest wholesale jewelry distributor in the southwestern United States, had such an impact on the wholesale jewelry distribution business and was so well known nationwide in the industry (through Oneida and International Silver Companies, General Electric Appliance Division, Timex, and Waltham Watches) that there was not an interested or prospective buyer who was not aware of the availability for purchase of the merchandise inventory and the furniture and fixtures.

It is submitted that no extraordinary services were rendered by Appellant nor any special benefit received by the estate from her services in connection with the sales of the bankrupt's tangible assets.

Proposed Sale of Accounts Receivable.

Appellant also seeks to take credit for the fact that a proposed sale of all of the accounts receivable for $29,500 was blocked by reason of her objections. This item is treated in the Appellant's Opening Brief as though she were solely or largely responsible for preventing this sale, and she also stated that the then Referee was in favor of the sale, and "reluctantly authorized the Trustee to collect the accounts receivable, rather than confirm a sale of same." (Appellant's Op. Br. p. 4, lines 14-24.)

Appellant's assertions and intimations are not in accord with the facts or the testimony. It was Mr. Hus-

on, the Chairman of the Creditors' Committee, who strongly objected to the proposed package sale of all of the bankrupt's accounts receivable. While Miss McConnell, as the attorney for the Trustee, may have joined with Mr. Huston in his objections, she was most certainly not the principal moving force. On the contrary, she had, in advance of the hearing, prepared a petition and order for the sale of the receivables presumably with the idea of using the documents. [See p. 10, line 22, of Schedule "A" to Petition Of Trustee's Attorney for Compensation, etc., Clk. Tr. p. 55.] It does not seem reasonable that Miss McConnell, if she were going to "vigorously" oppose the package sale of all the accounts receivable, would prepare a petition *and order* for such sale in advance of the creditors' meeting at which the matter was to be considered. Such advance preparation would suggest that both the Trustee and Miss McConnell, if not in favor of the sale, were certainly not opposed. It would also suggest that her later opposition was in the nature of a "leap onto the bandwagon".

Additionally, it should be pointed out that of the $126,000 of active receivables, 75% were current. One could reasonably expect to collect $90,000 to $100,000 out of these receivables with little or no effort other than the sending of statements. One might also expect to collect some part of the remaining $162,000 of inactive receivables. Anyone with reasonable business judgment would conclude that an offer of $29,500 for accounts receivable of an old established business of the face value of over $288,000 of which almost $100,000 were then current, is an offer which should be rejected out of hand.

It is straining rather hard for the attorney for the Trustee to take credit for and claim benefit to the bankrupt's estate in joining in objections to a sale which, if it had been made, would probably have subjected the Trustee to severe criticism if not a charge of mismanagement.

Collection of Receivables.

The other major item on which Miss McConnell claims entitlement to fees is the handling of the accounts receivable.

Appellant, in support of her claim for more fees, attempts to use collection agency standards and percentages. Such a basis is entirely inappropriate. Collection agencies or collection attorneys are not retained or employed to collect accounts receivable which are current or which are not badly delinquent. They are given and employed to handle those accounts which the creditor has not been able to collect by the use of ordinary or regular collection efforts employed by business.

An analysis of the results of the entire collection effort reveals that nothing out of the ordinary was accomplished; rather, the collection effort produced disappointing results and at substantial cost over and abov the fees allowed to the Trustee, to the accountant Mr Price, and to Miss McConnell.

The evidence showed that 7 actions were commence by Miss McConnell in Arizona (not 11 as asserted i Appellant's Op. Br. p. 15, lines 20 and 21), which re

ulted in collections of slightly less than $7,000 ($6,-958.55), not $59,638.85 as suggested in Appellant's Opening Brief (p. 5, lines 13-18, and p. 15, lines 21-28). (This last-mentioned sum was the total amount collected by the Trustee's efforts; the balance of about $26,000 was realized from the accounts referred to California collection agencies.) Few, if any, of these actions ever went to trial. [Ref. Cert. on Rev., ¶2, p. 5, Clk. Tr. p. 5.]

Selected accounts were referred to collection agencies in California and collections of $26,000 were effected at a cost to the estate of over $5,000. There is no evidence in the record of the face value of these accounts and presumably no better percentage of face value was realized from these accounts than from the collection effort as a whole.

The accounts receivable were classified by the bankrupt into Groups I, II, III and IV. Group I accounts were active, regular accounts, and Group II were active special accounts with extended terms such as the 6/6 plan (buy for six months, pay the next six months), or were on a note basis with up to 15 months to pay. In round figures, Group I had $31,500 outstanding and Group II had $95,000 outstanding. The face amount of the accounts receivable in Groups I and II was $126,533.55 at the time of the adjudication. In both of these groups, 75% of the accounts were current. Group III accounts were classified as doubtful, and Group IV accounts were classified as probably

uncollectible, however, none of the accounts in Group III and IV had been determined to be wholly uncollectible nor had they been written off. The face value of the accounts in Groups III and IV was $162,000. [Ref. Cert. on Rev., pp. 5 and 6, Clk. Tr. pp. 5 and 6.]

The collection efforts resulted in gross collections of slightly less than $90,000.

This is the result which is urged as requiring special recognition in the form of extra fees. If only the *current* accounts in Groups I and II were collected, the amount realized would have been $94,875.00 (75% of $126,500). These figures on the net collections would better support an assertion that the collection effort as to Group I and Group II accounts was both inadequate and ineffective and that little or no collection effort was made as to Group III and Group IV accounts. These figures certainly do not support Appellant's position that the collection efforts were exceptional and the results greater than could have been reasonably expected.

A comparison of the amounts collected from the accounts receivable with the estimated value placed on these accounts by the bankrupt only demonstrates the size of the error made by the bankrupt. It hardly supports the proposition that the Trustee's efforts produced exceptional results. The classification by the bankrupt of the active and inactive accounts receivable and the current or delinquent status of these accounts provided a much better guide to their value and collectibility.

Performance of Trustee's Duties by Appellant.

Appellant objects to the Referee's Finding that:

> "A substantial amount of the time and effort of the attorney for the trustee was spent in performing the duties of the trustee in administering the estate" (Appellant's Op. Br. p. 17).

Appellant follows this objection with the bold and bald statement: "We can find no justification at all in the record to support this finding."

The Referee's Certificate on Petition for Review constitutes part of the record, and a very substantial part as regards the issues of fact. The following is quoted from said Certificate, page 6, paragraph 3 [Clk. Tr. p. 6]:

> "3. Time Devoted—The Referee also considered the time spent by the attorney for the trustee, which time by the evidence presented approximated 200 hours. The Referee determined that a substantial portion of this time was actually spent by the attorney for the trustee in doing the work of the trustee and not a representative capacity."

Reference is also made to Schedule "A" to Petition of Trustee's Attorney for Allowance of Compensation, etc. [Clk. Tr. pp. 46-65] wherein there are *26* separate references in Miss McConnell's detailing of time charges to "Work On Receivables" or work with receivables exclusive of any reference to lawsuits or other special legal work. How much of the correspondence read or sent, also referred to in Miss McConnell's detailing of time charges in Schedule "A", was related to collection of receivables is not shown but it must

have been a large part as there was little activity in the estate administration following the sale of the tangible assets other than the collection of receivables.

Time Elements.

The time elements in this matter are two in number, one, the length of time it took to complete the administration, and two, the time spent by Appellant, Miss McConnell, as the attorney for the Trustee.

As to the first time element the only appropriate comments are that the creditor's money was and is being withheld from them for much too long a time, and the issues raised as to the debenture holders should have been raised and disposed of at least two years ago.

The other time element involves the time spent by Miss McConnell in performing her duties as attorney for the Trustee. The amount claimed and found to have been spent is about 200 hours. Of this total 165 hours was the subject of detailed itemization. [Schedule "A" to Petition of Trustee's Attorney for Compensation, etc., Clk. Tr. p. 46, *et seq.*] The balance spent subsequent to the filing of said petition.

Most of the work so detailed appears not only to be routine in nature but a great deal of the time spent appears to have been spent on collection of receivables. It is submitted that compensation at the rate of $40 per hour for this kind of work is adequate, if not generous.

Appellant's detailing figures for rent and other overhead expenses are not pertinent or relevant as it is a matter of common knowledge in the legal profession that these items of cost and the services of the attorney's secretaries and other non-legal personnel are included in his hourly charge.

It should also be noted that Miss McConnell was awarded $1,500 fees as the attorney for the Receiver. The receivership spanned a period of one month, July 5 to August 5, 1963. Though she claimed to have spent "approximately 70 hours" as the Receiver's attorney, her detail of her time charges in Schedule "A" to her Petition Of Attorney For Receiver For Allowance Of Compensation And Reimbursement [Clk. Tr. pp. 69-74] totals only 39 hours 10 minutes, again at a rate of about $40 per hour.

It is also noteworthy that the work performed during the period of the receivership included a much greater proportion of strictly legal services than the period during which Miss McConnell served as attorney for the Trustee. No appeal has been taken from the portion of the Referee's order awarding Miss McConnell fees as the attorney for the Receiver.

Conclusion.

It is submitted that the award of $8,000 to Miss McConnell for her services as attorney for the Trustee was adequate compensation for the services rendered.

It is submitted that there is ample evidence to support the Referee's Order making the award of attorney's fees.

It is also submitted that there is no showing of any abuse of discretion by the Referee in awarding attorney's fees as aforesaid, or that the Order of the Referee as confirmed by the District Court is "clearly erroneous".

Dated at Los Angeles, California, February 2, 1968.

Respectfully submitted,

Burris & Lagerlof,

By Stanley C. Lagerlof,

Attorneys for Appellee, Gladys Reynolds Butler, Executrix of the Estate of Walter H. Butler, Deceased.

Certificate of Counsel.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Stanley C. Lagerlof

Nos. 22,188 and 22,188-A

United States Court of Appeals

For the Ninth Circuit

Beverly J. McConnell, *Appellant,* vs. Estate of Butler, *Appellee,*		No. 22,188
and Oscar Stroble, Trustee, *Appellant,* vs. Estate of Butler, *Appellee.*		No. 22,188-A

On Appeal from the United States District Court for the District of Arizona

APPELLANT'S CLOSING BRIEF

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

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and		
OSCAR STROBLE, Trustee, *Appellant,* vs. ESTATE OF BUTLER, *Appellee.*		No. 22,188-A

On Appeal from the United States District Court for the District of Arizona

APPELLANT'S CLOSING BRIEF

NO TRANSCRIPT OR SUMMARY OF THE EVIDENCE

Appellant directs attention to the argument of Appellee that there is not sufficient record on which to predicate a reversal or modification of the Referee's Order allowing fees to Appellant. We do not agree with this contention. If it has merit, Appellant should not be penalized because she sought, by objections to the Referee's Certificate on Review and by request for amendments thereto, to have either a transcript of the evidence or a summary thereof. The District Court denied her objections and request. It

is because of this situation that Appellant asks for the matter to be referred back to the Referee if the Court does not agree with the contention of Appellant that the allowance of only $8,000.00 as a fee is so low as to amount to an abuse of discretion. Would it not have been more appropriate if counsel for Appellee had joined in the request of Appellant before this matter reached this Court, rather than to here seek an advantage because of the asserted insufficiency of the record?

The designation of the Estate of Butler as the sole Appellee, says counsel for Appellee, "is probably legally incorrect and factually an error." However designated, the fact remains that the Estate of Butler is the only creditor or party who objected to the fee sought by Appellant.

The record shows that Appellee's counsel were the lawyers for E. W. Reynolds Company prior to its bankruptcy and have since represented the family who substantially owned the company in the bankruptcy proceedings. This situation should be borne in mind when considering the argument made in behalf of Appellee that the efficiency and organization of the E. W. Reynolds Company was so great that it, even in bankruptcy, could run itself; that its debtors would pay their indebtedness (accounts receivable) without collection efforts by the Trustee; that its fame was so great that in liquidation its assets sold themselves; that the services of Appellant were wasted efforts; and that there was just nothing for Appellant, as counsel for the Trustee, to do. This

bankrupt thought the value of all of its accounts receivable was only $50,000.00. It thought its merchandise inventory had a value of only $35,500.00 and that its furniture and fixtures had a value of only $1,650.00. Bankrupt didn't think its name had any value at all.

Factually, as in any Bankruptcy, the "birds of prey" do gather—and debtors for some reason or other believe there is no longer any need to make payment. Even in the best of bankruptcies it takes intensified effort to realize for creditors a reasonable market value—a "top dollar" for assets in liquidation. The E. W. Reynolds Company was no different. It was just because of the obvious value of the business and its various components that maximum effort was expended by the Trustee and Appellant; that solicitation of offers to purchase and negotiation for sale of the assets were conducted on a greater basis than in the normal case. The assets of this bankrupt company were not "dumped on the market" as is sometimes the case. The efforts of the Trustee, the Attorney for the Trustee and the Creditors' Committee were very successful—and the Trustee did realize an outstanding sum on liquidation. The record will show that this was within a minimum time. The processing of the accounts receivable, however, took approximately twenty-one (21) months due to the fact that some did have extended terms of payment, that suits in some instances were required, and that even where voluntary payment was possible the Trustee found it necessary in many cases to grant additional time for payment and to allow payouts on an installment basis.

DELAYS IN CLOSING ESTATE

Contrary to the suggestion of Appellee, any delay in the closing of the estate was not occasioned by Appellant or the Trustee. The Trustee filed his final account and requested the estate be closed in May of 1965. No ruling was made by the Referee on the questions presented at the final meeting of creditors until October of 1966. A Petition for Review was filed in November of 1966. The Referee's Certificate on Review was not filed until March of 1967. The lack of payment of partial dividends was not by choice of the Trustee or Appellant, but rather was due to the refusal of the Referee to permit same.

EFFICIENCY OF TRUSTEE'S ADMINISTRATION

A review of the entire record will show the efficiency of the Trustee's administration. The efficiency of that administration is substantially the result of the efforts of Appellant in her guidance and representation of the Trustee, in her assistance in negotiating for sale of the assets and in her arranging for the interest-bearing deposit of the estate's funds. The success of the Trustee in collection of the accounts receivable after the first meeting of creditors is due entirely to the efforts of Appellant as Attorney for the Trustee.

TIME ELEMENT

Appellant has requested a fee of $30,000.00. The record reflects that Appellant has reported approxi-

mately 100 hours were expended in general administrative work up to the time of the final meeting of creditors. An additional 100 hours of time has also been reported on accounts receivable work. It is not a fact that the second 100 hours was the total amount of time expended in collecting accounts receivable. The record shows that Appellant has, at all times, advised that she did not keep time records of work done on collection matters; that they were handled by her office employees, she having an established system for processing collection of accounts on a volume basis, and that it is physically impossible to report time expended in collection work. No doubt the amount of time spent on the receivables did run into many hundreds of hours. Surely a court, no more than an astute businessman, expects that it will be asked to pay for collection work on a time basis. No one, realistically, will pay for time devoted that does not result in collections.

ACCOUNTS COLLECTED

Argument is made that \$90,000.00 to \$100,000.00 of the accounts receivable were current. "Current" is not synonymous with "good" or "collectible", particularly when the creditor is in bankruptcy. The bankrupt knew this when it scheduled the accounts receivable as having a value of \$50,000.00. The fact is inescapable that, had Appellant not undertaken collection of the accounts receivable (slightly under 500 accounts) and assumed in her office all of the expense

thereof, the creditors would have realized $46,000.00 less on these accounts.

INTEREST ON SAVINGS ACCOUNTS

The fact remains that the interest earned on monies of the estate is the result of the sole effort of Appellant. Appellee's counsel, attempting to minimize, or to allocate the service entirely to the receivership, is not convincing. The result speaks for itself.

SUCCESS

All authorities agree it is the success of the work undertaken which is of paramount importance in determining the reasonableness of a fee. *Collier on Bankruptcy,* 14th Edition, Sec. 62.12(5), pp. 1488-1489, states:

> "... economical is by no means synonymous with 'parsimonious', and should not exclude a compensation that is under all the circumstances of the case fair and reasonable. To reserve as much as possible for distribution to the creditors is one postulate, but there is another, perfectly compatible with the former, not to discourage needlessly able and competent lawyers from accepting a retainer in bankruptcy by denying them reasonable remuneration. A misunderstood economy in this respect may lead to evils far greater than the sacrifice imposed on the individual creditor by reason of an equitable allowance for meritorious and diligent counsel."

The District Court has mistaken the intent of the Bankruptcy Act in determining the standards to be applied in fixing a reasonable fee for services rendered by Appellant. In *Jacobowitz v. Double Seven Corporation,* 378 F.2d 405, June 5, 1967, this Court has once and for all clarified that "determining reasonable fees in Bankruptcy cases is no different from determining them in private employment except that the spirit of the Bankruptcy Act would seem to require a Court to fix such fees at the lower end of the spectrum of reasonableness." No longer can fees less than those normally allowed in the community be justified as reasonable in bankruptcy proceedings.

We urge that this Court should, in light of its ruling in the *Jacobowitz* case, reappraise the allowance of the fee to Appellant herein, to take into consideration the benefit which has flowed to the bankrupt estate and its creditors from the services rendered by Appellant.

> ". . . it is not surprising to find that aside from the principle of economy the results achieved constitute the factor of greatest determinative weight.
>
> > 'Success is the test applied by the business world in measuring compensation. It is largely so in the course. As a rule professional services however able or prolonged which yield no results command no higher reward.'
>
> "This implies that (1) great success and benefit to the estate command a liberal compensation and (2) all effort and labor may go virtually without reward where benefit accrued to the estate. Benefit to the estate as a yardstick for measuring the

value of attorney services has been recognized by the Supreme Court in *Randolph v. Skruggs,* 190 U.S. 533."

CONCLUSION

Considering the quality and quantity of services rendered by Appellant, the benefit which the creditors have and will realize therefrom, and the standards for determining the reasonableness of a fee as set forth in the *Jacobowitz* case, it ought to be concluded that $30,000.00 is the reasonable fee to be allowed to Appellant herein.

Dated, Phoenix, Arizona,
February 22, 1968.

Respectfully submitted,
STOCKTON & HING,
By HENDERSON STOCKTON,
Attorneys for Appellant Beverly J. McConnell.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HENDERSON STOCKTON.

No. 22,188-A

United States Court of Appeals

For the Ninth Circuit

In the Matter of
E. W. REYNOLDS COMPANY,
Bankrupt.

BEVERLY MCCONNELL, and OSCAR STROBEL, Trustee of the Estate of E. W. Reynolds Company,
Appellants,

vs.

ESTATE OF W. H. BUTLER, Deceased, CERTAIN DEBENTURE HOLDERS,
Appellees.

On Appeal from the United States District Court for the District of Arizona

REPLY BRIEF FOR APPELLANT OSCAR STROBEL, TRUSTEE OF THE ESTATE OF E. W. REYNOLDS COMPANY, BANKRUPT

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

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Appellants,
vs.
Estate of W. H. Butler, Deceased, Certain Debenture Holders,
Appellees.

On Appeal from the United States District Court for the District of Arizona

REPLY BRIEF FOR APPELLANT OSCAR STROBEL, TRUSTEE OF THE ESTATE OF E. W. REYNOLDS COMPANY, BANKRUPT

INTRODUCTION

Appellant stands on the presentation of Facts and Law set forth in his opening Brief. Despite Appellees' professed exceptions to the Appellant's statement, the essential facts in the case are not in dispute. Indeed the litigation is not concerned with the resolution of disputed facts, but rather with the legal effect of the transactions involved.

Although Section 39(a) of the Bankruptcy Act imposes upon the Referee the duty of providing a "transcript of the evidence or a summary thereof" we do not have such a transcript or a summary. All efforts by Appellant to compel the preparation of such a transcript or summary have been unsuccessful. No one regrets this incompleteness of the record more than Appellant, but, nevertheless, we submit that a review of the exhibits which have been transmitted to this Court, and the Findings of Fact which remain unchallenged, will reflect the error of the lower Court's decision.

ARGUMENT

POINT 1

DISALLOWANCE OF DEBENTURE CLAIMS

Appellees' Brief is not responsive to the primary issue in this Appeal, to wit: whether debentures of a corporation issued in payment of repurchase price of its stock, may be enforced if the corporation has no surplus when payment is to be made, and whether when the corporation is in Bankruptcy, holders of such debentures may share on a parity with the corporation's creditors.

Appellees have cited no authority to refute the great volume of cases determining the complete unenforceability of an agreement to repurchase stock in the absence of surplus. The reason is obvious, as on this point, all authorities, whether they be in the corporate, bankruptcy or contract field, concur.

We point out to the Court again that we are not concerned here with the so-called "under capitalization cases", where money is advanced to capital, under the guise of a loan, nor are we concerned with the creditor vs. creditor situation where no investment in capital has ever been intended (such as the *Arnold v. Phillips;* the *In re L. M. Alleman Hardware Co.;* the *Brown v. Freedman;* and the *Kansas City Journal* case as cited by Appellees). And contrary to the suggestion made by Appellees, the approval of the California Division of Corporations of the debenture issue, does not in any way establish or reflect the validity or enforceability of the agreement of the E. W. Reynolds Company to repurchase its own stock (*England v. Christianson,* 243 A.C.A. 478).

There is no dispute that Appellees originally invested in the capital of the E. W. Reynolds Company and received stock therefor; that they agreed to sell and have sold this stock back to the company; that the debentures evidence the agreement of the company to pay them a fixed sum for this stock, and that there is no surplus from which payment can now be made.

POINT 2

SUBORDINATION OF THE CLAIMS

The Courts have established criteria for determining the propriety of subordination; obviously each case must be determined on its own merits. Our Supreme Court has however stated:

> "The question to be determined when the plan or transaction which gives rise to a claim is challenged as inequitable, is whether within the bounds of reason and fairness such a plan can be justified." (*Taylor v. Standard Glass,* 306 U.S. 307, 59 S.Ct. 543.)

Fraud is not a prerequisite to subordination (*Costello v. Fazio,* 356 F.2d 903, 9th C.C.A.).

Here we do know that the debenture claimants were well aware of the financial condition of the E. W. Reynolds Company prior to the time they elected to convert their stock to a debenture; that they realized that they may never receive payment for their stock if the company did not improve its financial condition, but that the alternative was possible loss of the stock due to inability to pay the subscriptions therefor; that the debenture-stock exchange plan offered to them the possibility of recovery of their total investment plus interest, rather than the retention of stock with the uncertainty of dividends; that the debenture claimants did receive the "benefits of their bargain" in that they have recovered a substantial part of this investment, while creditors have not received the benefit of any such bargain; that the debenture holders who invested without the expectation of withdrawal, have partially recovered their investment while the creditors who advanced real value to the company, with full expectation and promise of payment, have received nothing. Surely it is inequitable to allow such claimants now to withdraw funds from the corporation to the detriment of these creditors.

CONCLUSION

Appellant requests that the Court determine that the claims of the debenture holders are "as a matter of substantial economic and legal reality" claims for repayment of capital or proprietary interest, for payment of purchase price of stock sold by them to the corporation, that they are not therefore "debts" and they may not be allowed as a claim in the Bankruptcy Estate; or in the alternative that equity requires such claims to be subordinated to the payment of creditors of the corporation.

Dated, Phoenix, Arizona,
February 19, 1968.

Respectfully submitted,
Beverly J. McConnell,
Attorney for Appellant
Oscar Strobel.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Beverly J. McConnell,
Attorney for Appellant
Oscar Strobel.

No. 22190

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

GENERAL INSURANCE COMPANY OF AMERICA,
a corporation,

Appellant,

v.

ROCKWOOD WATER DISTRICT, a municipal
corporation,

Appellee.

APPELLANT'S BRIEF

Appeal from the Final Judgment of the United States
District Court for the District of Oregon

THE HONORABLE ROBERT C. BELLONI, Judge

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IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NERAL INSURANCE COMPANY OF AMERICA,
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v.

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rporation,

Appellee.

APPELLANT'S BRIEF

Appeal from the Final Judgment of the United States
District Court for the District of Oregon

THE HONORABLE ROBERT C. BELLONI, Judge

STATEMENT OF JURISDICTION

This action was filed on March 14, 1966, in the rcuit Court of the State of Oregon for the County of ltnomah (R[1] 1, 5-7).

[1] he record on appeal is referred to herein as "R."

March 31, 1966, appellant filed its petition for removal (R. 1-71), bond on removal (R. 72-74) and notice of filing petition and bond for removal (R. 75-76) in the United States District Court for the District of Oregon.

The jurisdiction of the District Court was properly invoked and the action was properly removed under the provisions of 28 USCA, Section 1441, as the District Court had original jurisdiction of the action under 28 USCA, Section 1332. This jurisdiction obtained because the parties are citizens of different states and the matter in controversy exceeds the sum of $10,000, exclusive of interest and costs (R. 2).

The action was tried before The Honorable Robert C. Belloni, sitting without a jury, on April 27 and 28, 1967 (R. 92-93). June 21, 1967, the court entered its opinion (R. 199-205) for appellee. Final judgment was entered for appellee on July 7, 1967 (R. 206-207).

Appellant filed its notice of appeal on August 3, 1967 (R. 208), within the time allowed by Rule 73(a), Federal Rules of Civil Procedure.

By reason of the foregoing, this court has jurisdiction to review the judgment of the District Court under the provisions of 28 USCA, Section 1291.

STATEMENT OF THE CASE

A. Nature of the Action

This is a declaratory judgment action brought by Rockwood Water District ("appellee") against General Insurance Company of America ("appellant"). It was brought to determine the relative rights, duties and liabilities of the parties under two comprehensive liability policies issued by appellant to appellee (R. 95).

B. Summary of Facts

Appellee is a water district located east of Portland, Oregon. It supplies its users with Bull Run water purchased from the city (R. 95).

The policies involved in this case are comprehensive liability policies issued by appellant to appellee covering the periods from June 1, 1962, to June 1, 1963 (Policy A)[2] and June 1, 1964, to June 1, 1965 (Policy B)[3] (R. 95). Pretrial Exhibits A (R. 110) and B (R. 135) are copies of Policy A and Policy B, respectively.

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[2] Examination of this policy indicates that it covered the policy year 1962-1963. No policy was issued for the policy year 1963-1964, but the original policy continued in effect.

[3] This policy was cancelled on December 14, 1964, and appellant refunded to appellee the portion of the premium which was unearned (R. 95).

The following provisions of Policy A are relevant to the question presented on this appeal (R. 111, 130, 131):

> "GENERAL INSURANCE COMPANY OF AMERICA * * * AGREES with the insured, named in the declarations made a part hereof, in consideration of the payment of the premium and in reliance upon the statements in the declarations and subject to the limits of liability, exclusions, conditions and other terms of this policy: * * *
>
> "CONDITIONS
>
> "* * * 8. Action Against Company. No action shall lie against the company unless, as a condition precedent thereto, the insured shall have fully complied with all the conditions hereof, * * *
>
> "13. Subrogation. In the event of any payment under this policy, the company shall be subrogated to all the insured's rights of recovery therefor and the insured shall execute all papers required and shall do everything that may be necessary to secure such rights."

Policy B contains the following provisions relevant to this appeal (R. 136, 157):

> "GENERAL INSURANCE COMPANY OF AMERICA * * * AGREES with the insured, named in the declarations made a part hereof, in consideration of the payment of the premium and subject to the limits of liability, exclusions, conditions and other terms of this policy: * * *
>
> "CONDITIONS
>
> "* * * 7. Action Against Company. No action shall lie against the company unless, as a condition precedent thereto, the insured shall have fully complied with all the terms of this policy, * * *
>
> "9. Subrogation. In the event of any payment under this policy the company shall be subrogated to all the insured's rights of recovery therefor against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights."

[illegible]

[illegible]

[illegible] * * *

[illegible]

* * * [illegible] * * *

[illegible]

[illegible]

[illegible]

[illegible] * * * [illegible] * * *

[illegible]

* * * [illegible] * * *

[illegible]

Before the first policy was issued, a problem arose with respect to tar particles in the water furnished by appellee, resulting from appellee's use of defective water pipe which it had purchased from Beall Pipe & Tank Co.("Beall"). Commencing in 1960, complaints were received by appellee concerning foreign substances in the water (R. 98, 100; Exs. 60, 84, 85, 86, 94).

March 1, 1963, appellee filed an action in the Circuit Court in Multnomah County, Oregon, against Beall to recover damages allegedly resulting from the purchase of the defective water pipe by appellee from Beall (Pretrial Ex. J, R. 173). Appellant was not notified that this action had been filed. Appellee sought to recover damages for the following items (R. 204):

"1) diminution in the value of the pipe;

"2) depreciation in value of the District's water system;

"3) expense in removal of loose asphalt material from the system; and

"4) expense of repairing and replacing parts of the system."

January 27, 1964, Electronic Specialty Co.("Electronic") complained to appellee that tar from the water was getting into its welding water cooling lines and that its boiler was corroded. At that time, Electronic requested a water analysis (R. 96).

May 19, 1964, Suzanne Spangler advised appellee that she was experiencing difficulties because of tar in the water (R. 97).

By letter dated July 9, 1964 (Pretrial Ex. C, R. 159), Electronic notified appellee that it intended to claim damages resulting from the tar in its water supply, a matter which had been brought to appellee's attention "some months past." Electronic further advised that the extent of its damages had not as yet been ascertained.

October 7, 1964, appellant learned for the first time of appellee's pending action against Beall. On that date, appellant's representatives Thomas E. Wernette, Thomas K. Klosterman, Jr., and Charles G. Carson attended a meeting at Electronic's plant (Ex. 91, page 7). At that meeting, appellant was advised that appellee had commenced a lawsuit against Beall, which was then on the eve of trial (Ex. 91, pages 9-11; Ex. 90, pages 16-17; Ex. 16; Ex. 18; Tr.[4] 115).

Appellee's action against Beall was tried commencing October 12, 1964 (Pretrial Ex. J, R. 192).

By letter dated October 23, 1964, appellant advised appellee that the latter's action against Beall was prejudicial to appellant's right of subrogation against Beall (Ex. 1 to Ex. 91):

[4]The transcript of testimony is referred to herein as "Tr."

"If at some later date we should settle such claims or pay any judgment, it would appear that our right to subrogation against Beall Pipe & Tank Corp. has been lost by your filing of the lawsuit to which reference has been made and to proceeding to trial of such lawsuit."

January 24, 1965, Mr. and Mrs. Spangler ("the Spanglers") submitted a written claim to appellee for damage to clothes and appliances and for inconvenience (R. 97).

March 2, 1965, judgment was entered in favor of appellee in its action against Beall in the sum of $200,000 (Pretrial Ex. J, R. 190).

July 12, 1965, appellant advised appellee that the claims asserted by Electronic and the Spanglers were not covered by its policies (R. 96, 97; Pretrial Ex. E, R. 162).

November 4, 1965, the Spanglers filed an action against appellee in the Circuit Court in Multnomah County, Oregon, to recover damages allegedly resulting from appellee's failure to supply the Spanglers' residence with water which was safe and adequate for their domestic use (R. 97). Pretrial Exhibit I is a copy of the second amended complaint in that action (R. 171). Appellant declined to proceed with the defense of the Spanglers' action when such defense was tendered to it (R. 97). The Spangler claim was ultimately settled by appellee for the sum of $400.

January 25, 1966, Electronic filed an action against appellee in the United States District Court for the District of Oregon to recover $65,400 in damages for alleged losses to

its plant equipment and products resulting from impurities in the water supplied to it by appellee (R. 96). Pretrial Exhibit F is a copy of the complaint in that action (R. 164). Appellant declined to proceed with the defense of this action when the same was tendered to it (R. 97; Pretrial Ex. G, R. 169).

By this declaratory judgment proceeding, appellee sought to compel appellant to defend the Electronic and Spangler claims and to pay all damages appellee might be required to pay to Electronic and the Spanglers (R. 101-102).

C. Nature of the Judgment

By its judgment in this case (R. 206-207), the District Court held that appellant is obligated (1) to defend the action brought by Electronic against appellee, and to pay all damages and costs appellee may become legally bound to pay therein, (2) to reimburse appellee for the amount it paid the Spanglers in settlement of their action against appellee, plus interest from the date of payment, and (3) to pay appellee its reasonable expenses and attorneys' fees incurred in the Electronic and Spangler actions and in this action.

D. Question Presented on Appeal.

A number of issues were presented to the District Court in this case, all of which were ruled upon by the court. This appeal, however, relates to only one of the issues which

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

which were before the trial court for determination, that is, the effect of appellee's action against Beall upon the policy coverage.

At trial, appellant showed the court that appellee, having already obtained a judgment against Beall, could not effectively subrogate appellant for appellee in any future proceeding against Beall based upon the Electronic and Spangler claims because of the defense of res judicata. Nevertheless, the trial court, without citing any authority, held (R. 203-205) to the contrary.

Accordingly, the question presented for determination on appeal is whether the District Court erred when it concluded that appellant's right of subrogation has not been rendered valueless or destroyed by reason of the availability to Beall of the defense of res judicata. If the answer to this question is in the affirmative, then judgment must be entered for appellant.

SPECIFICATION OF ERROR

The District Court erred when it concluded (R. 203-205) that appellee's action against Beall and the judgment in such action did not destroy or render valueless appellant's right of subrogation in any action against Beall based on the Electronic and Spangler claims.

SUMMARY OF ARGUMENT

The judgment appellee obtained against Beall destroyed or rendered valueless appellant's right of subrogation in any future proceeding against Beall because of the defense of res judicata.

ARGUMENT

<u>The District Court erred when it held that appellee's judgment against Beall did not prejudice or render valueless appellant's right of subrogation.</u>

As indicated hereinabove (supra, page 4), appellant had rights of subrogation under both policies. Furthermore, these rights would have obtained even in the absence of express policy provisions.

<u>American Central Ins. Co. v. Weller (1923)</u>
<u>106 Or 494, 502-503, 212 Pac 803, 805</u>

> "It is unquestionably the general rule that on payment of a loss, the insurer acquires the right to be subrogated pro tanto to any right of action which the insured may have against any third person whose wrongful act or neglect caused the loss: 14 R. C. L., p. 1404, § 568, note."

In this case, appellee seeks to have a judgment entered requiring appellant to defend the claim asserted by Electronic, to satisfy any judgment against appellee, and to pay any amounts expended in settlement and related expenses. Under the policies and general legal principles, if appellee's position is correct, appellant ordinarily would have the right of subrogation to appellee's cause of action against Beall arising out of the Electronic and Spangler claims, and therefore to recover the amount of its loss from Beall. However, appellee's own conduct in obtaining a judgment against Beall under the circumstances previously set forth has destroyed

or rendered valueless the right of subrogation against Beall, which appellant might otherwise have had.

Thus, an insurer's rights of subrogation are derived from the insured's right to recover as against the wrongdoer. Accordingly, if the insured, for example, effectively releases the wrongdoer, as by obtaining a judgment against him for the loss, the insured destroys his own right, if any, to pursue the wrongdoer, and, with that right, both the insurer's rights of subrogation and the insured's right under the policies against the insurer.

29A Am Jur, Insurance, Section 1738, page 810

> "Since the right of an insurer to subrogation against the one responsible for the loss is derived from the right of the insured against such person, the right of the insurer against the wrongdoer may be defeated by any act of the insured, prior to the loss, or even after the loss, amounting to an effective release of the wrongdoer from liability. Thus, the insurer's right to subrogation may be defeated * * * where the insured recovers the amount of the loss from the wrongdoer; * * *"

6 Appleman on Insurance Law and Practice, Section 4095, pages 596-597

> "It has been held that a recovery by the insured from a third person whose negligence caused the loss, extinguishes the liability of the insurer. The reason for this rule has been stated to be that such action by the insured renders it impossible for him to assign his rights to the insurer, in accordance with his subrogation agreement."

Packham v. German Fire Ins. Co. (1900) 91 Md 515, 526
46 Atl 1066, 1068

"It yet remains for us to determine whether the proceedings resulting in the judgment against the gas company released the wrongdoer and destroyed the defendant's right of subrogation. Now, there was in this case but one tortious or negligent act of the gas company resulting in one fire which occurred at one and the same time, as well the loss incurred under this policy as the loss incurred under the other policies for which recovery was had against the gas company. This is admitted by the demurrer, as well as the further facts that that suit was for the whole loss occasioned by the fire; that there was no reservation of any right by the plaintiff for the protection of this defendant, and no agreement qualifying the effect of the verdict, and that by the direction of the plaintiff the recovery did not include any compensation for loss incurred under this policy, and the defendant has no interest in the recovery as to the policy with which we are now concerned. For a single indivisible tort but one suit can be brought. The plaintiff in this case could not now bring another suit against the gas company for his own benefit to recover the loss incurred under this policy, nor could such suit be brought in his name for the benefit of the defendant. * * * The plaintiff had one indivisible cause of action against the gas company, and that cause of action has been merged in the judgment he obtained. When he excluded from that judgment so much of that cause of action as relates to this policy, he as effectually released so much of his right of action as if he had executed and delivered a release under seal therefor, and as clearly and unequivocally destroyed the defendant's right of subrogation as he would have destroyed it by such release. Any act which makes performance of the agreement to assign either impossible or useless must relieve the insurance company from its concurrent obligation to pay. The plaintiff in the present case, in order to protect his larger interests under the other policies, and his interest in recovery for loss of profits which were uninsured, has seen fit, for reasons doubtless satisfactory to him, to sacrifice his own and defendant's interest under the policy in question, and cannot now be heard to complain of the result of his own course of conduct."

[illegible]

[illegible]

In the case at bar, appellee has recovered judgment against Beall for the full amount of its alleged losses, namely:

1. Diminution in the value of the pipe;

2. Depreciation in value of the District's water system;

3. Expense in removal of loose asphalt material from the system; and

4. Expense of repairing and replacing parts of the system.

Under the foregoing authorities, appellant's right of subrogation has been extinguished or rendered valueless and with it, appellee's rights, if any, under the policies.

The District Court concluded, however, that an action may be maintained against Beall based on the Electronic and Spangler claims, despite the judgment already entered against it (R. 204-205):

> "There was no claim by Rockwood for damages suffered by its customers, and this is the only type of damage for which General might have any right of subrogation.
>
> "The Electronic and Spangler causes of action had not arisen on March 1, 1963, the date the Beall action was filed; they had not matured at the time the action was tried in October of 1964. Electronic Specialty Company did not ascertain the amount of damage it had sustained until December 1, 1965, and Spanglers did not claim damages from Rockwood until January 24, 1965.

"Rockwood has done nothing to prejudice whatever rights it might have against Beall Pipe & Tank Company to recoup damages which Electronic might recover against Rockwood in its action now pending or the $400.00 damages paid by the District to Spanglers in settlement of their action. Therefore, the action by Rockwood against Beall Pipe & Tank Company and the resulting judgment has not prejudiced any rights of subrogation of General Insurance."

This of course ignores the rule, referred to in the authorities cited hereinabove, that a single tortious act (such as the sale of defective pipe by Beall to appellee) can be the basis of only one cause of action in tort. This cause of action cannot be divided into several demands and be made the subject of several lawsuits.

White v. Pacific Tel. & Tel. Co. (1942)
168 Or 371, 377-378, 123 P2d 193, 196

"It is also the general rule that a single, wrongful or negligent act can be the basis of but a single cause of action ex delicto, and that such a cause of action cannot be divided into distinct demands and be made the subject of separate suits."

The same rule applies in actions ex contractu.

Johnson v. Prineville (1921) 100 Or 119, 122
196 Pac 821, 822

"It is plain that the contract involved is an entire contract. The work was not to be done by installments. On the contrary, there was but a single task to be performed for a single compensation. Normally, only a single cause of suit or action would arise out of a breach of such a contract, so that the principle applies that no one can be twice vexed for the same cause of suit or action. * * *"

Beall committed a single act, whether it be regarded as tortious or breach of contract, when it sold the defective pipe to appellee. Appellee has recovered from Beall damages for the following items (R. 204):

> "1) diminution in the value of the pipe;
>
> "2) depreciation in value of the District's water system;
>
> "3) expense in removal of loose asphalt material from the system; and
>
> "4) expense of repairing and replacing parts of the system."

It has no further cause of action against Beall and neither does appellant by way of subrogation. As a result, any rights appellee might have had against appellant under the policies in suit have been extinguished.

Furthermore, the foregoing rules as to splitting causes of action apply whether or not all the damages were ascertainable at the time of the first action. See

Judd v. Comar Oil Co. (1935) 172 Okla 538, 45 P2d 532

This was an action to recover damages to a farm caused by drainage from an oil field. The trial court held that the action was barred by a former recovery in another action, and, on appeal, its judgment was affirmed.

The court stated (172 Okla 539, 45 P2d 533-534):

"It is the contention of plaintiff in this case in this court that the injuries complained of in this action were not included in the former case, and that at the time that case was tried they could not have been reasonably anticipated. It is important to note in this connection that it is not contended by plaintiff that the subsequent injuries to his farm were caused in whole or in part by wrongful pollution occurring subsequent to the first suit and recovery. In other words, the plaintiff is asserting that, even though the subsequent injuries were the result of the same wrongful pollution that previously permanently destroyed the 30-acre flood bottom portion of his farm, he is entitled to recover because he could not, at the time the former suit was tried, ascertain or anticipate subsequent damages to the portions of his farm not then injured, but which were subsequently injured as a result of the same tortious acts which caused the previous injury. * * *

"* * * The question of whether or not subsequent damages which were not ascertainable at the time of the previous action can be recovered in a second action, when both the previous and subsequent damages are the result of the same tortious act, is ably discussed in Freeman on Judgments, volume 2 of the Fifth Edition, at pages 1259 to 1263, inclusive. The learned author also recognizes in his discussion the underlying principles and reasons for adherence to the rule. We therefore deem it proper to quote at length. In discussing the subject he states:

"'Splitting Damages.---Where a cause of action consists in a right to damages, all the damages of whatsoever nature, both present and <u>prospective</u>, must be recovered in a single action; a recovery of part of them bars on (sic) another action for the remainder. The fact that the court erroneously restricts the party as to the damages which he may prove does not alter the rule, since he should have taken appropriate steps to correct the error. Neither does the fact that <u>damages were not known or ascertainable</u> or had not then been actually suffered, if the claim was single and indivisible, except in those courts which make an exception to the rule on the ground of unavoidable ignorance or mistake. * * *

"'Damages Not Ascertainable or Not Yet Suffered. ---In harmony with the general rule already stated, the fact that the damages sought to be recovered in the second action had not become apparent when the former judgment was obtained does not take the case out of the rule against splitting indivisible demands. * * * The rule yields to no hardship. Unforeseen and improbable injuries resulting from any act are, equally with existing and probable injuries, parts of an inseverable demand. * * * No case can arise involving claims for serious injuries to the person in which the assessment of damage, as the law now stands, can be otherwise than imperfect and unfair. In the majority of cases, defendants must pay for damages which never develop; while in the minority, the most serious injuries must be borne without compensation. * * *

"After a careful consideration of the reasons both for and against an adherence to the general rule, we have decided that it would be extremely dangerous to recognize an exception thereto.

"The policy of the law is that controversies should be settled and all questions that could have been litigated in a particular action are deemed to have been settled thereby. The mere fact that greater damage may result from an injury than was anticipated by the party at the time of trial does not authorize a second or subsequent recovery." (Emphasis added)

Appellant has located one case which is directly in point on the question of whether appellee, and consequently appellant, might now maintain an action against Beall based on the Electronic and Spangler claims. In that case the court concluded that the judgment in the first action was res judicata as to further claims, and, as a result, no further action could be maintained. See

[illegible]

[illegible]

[illegible]

[illegible]

Cohan v. Associated Fur Farms (1952) 261 Wis 584, 53 NW2d 788

In 1947 Associated sued Armour for recovery of damages for breach of implied warranty of fitness of pork livers sold by Armour to Associated. As a result of the diseased condition of the livers, some of Associated's mink died. Judgment was rendered in favor of Associated in January, 1949.

In April, 1949, Cohan advised Associated that he was claiming damages for loss of mink by reason of the feeding of the same pork livers sold to him by Associated. Thereafter he instituted the lawsuit against Associated to recover for such losses.

Associated filed a cross complaint in the second lawsuit against Armour for judgment over in case judgment was obtained by Cohan against Associated. Armour filed a motion for summary judgment against Associated based upon the contention that the judgment rendered in the first lawsuit by Associated against Armour was res judicata as to the cross complaint.

The court granted the motion for summary judgment of Armour and dismissed Associated's cross complaint against it stating (261 Wis 596, 53 NW2d 794-795):

"The judgment obtained by Associated in the federal court is res adjudicata. It might, in that action, have recovered all its loss 'directly and naturally resulting, in the ordinary course of events, from the breach of warranty,' Sec. 121.69(6), Stats., including any loss sustained on account of the resale of the livers to plaintiff. * * *

"The fact that it might have been difficult in the action in the federal court to establish the extent of its liability to Cohan does not prevent the application of the doctrine. The difficulty may be conceded. But it would not have been impossible. Notice to Cohan of its intention to sue Armour or the offer of his testimony, obtained by means of subpoena, if necessary, would have afforded Associated the means of establishing its probable loss and the extent of its liability to the plaintiff. It appears from the record that Associated had notice that Cohan had suffered loss on account of the feeding of the pork livers. It seems, however, that even if he had not had such notice the judgment entered in the federal court would preclude recovery upon the cross-complaint. * * *

"It is apparent, therefore, that the matter of Cohan's claim against Associated and Armour's liability to the latter on that account could have been litigated and determined in the federal court action. * * *

"The judgment bars the claim of Associated now asserted in its cross-complaint."

Applying the Cohan holding to our case, we find the following similarity:

Appellee (as did Associated) sued Beall (Armour) for (R. 204):

"1) diminution in the value of the pipe;

"2) depreciation in value of the District's water system;

"3) expense in removal of loose asphalt material from the system; and

"4) expense of repairing and replacing parts of the system."

While this action was pending and at least three months before the trial appellee (as did Associated) had notice that Electronic (Cohan) claimed to have suffered loss on account of impure water. At that point, several alternatives were available to Rockwood.

1. It could have filed an amended complaint containing a prayer for declaratory judgment as to the rights which it had against Beall as a result of the claims of Electronic, or

2. It could have delayed the trial of the Rockwood v. Beall case pending the outcome of the controversy between Electronic and Rockwood.

Rockwood did neither but instead proceeded to trial.

The case at bar is, if anything, even stronger than the Cohan case. Thus, in this case appellee had ample notice before trial of its action against Beall that Electronic and the Spanglers were claiming damages. These claims should have been asserted against Beall in that action, and the judgment against Beall is, of course, res judicata.

In conclusion, then, appellee's judgment against Beall is res judicata of any claim it might assert based on injuries to Electronic or the Spanglers. As a result, that

judgment has destroyed or rendered valueless appellant's right to be subrogated and any right appellee might have had to enforce the provisions of the policies before this court.

The District Court erred when it reached a contrary conclusion, and its judgment should be reversed.

CONCLUSION

For the reasons set forth hereinabove, the judgment of the District Court should be reversed and judgment should be entered for appellant.

Respectfully submitted,

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APPENDIX

EXHIBIT NO.	OFFERED	IDENTIFIED	RECEIVED
1	108		see footnote 5
2	108		see footnote 5
3	108		see footnote 5
4	108		see footnote 5
5	108		see footnote 5
6	108		see footnote 5
7	108		see footnote 5
8	108		see footnote 5
9	108		see footnote 5
10	108		see footnote 5
11	108		see footnote 5
12	108		see footnote 5
13	108		see footnote 5
14	108		see footnote 5
15	108		see footnote 5
16	108		see footnote 5
17	108		see footnote 5
18	108		see footnote 5
19	108		see footnote 6

Exhibit No.	Offered	Identified	Received
20	108		see footnote 5
21	108		see footnote 5
22	108		see footnote 5
23	108		see footnote 5
24	108		see footnote 5
25	108		see footnote 5
26	108		see footnote 7
51	108		see footnote 5
52	108		see footnote 5
53	108		see footnote 6
54	108		see footnote 6
55	108		see footnote 5
56	108		see footnote 5
57	108		see footnote 5
58	108		see footnote 5
59	108		see footnote 5
60	43	42 - 43	43
61	108		see footnote 5
62	108		see footnote 5
63	108		see footnote 6
64	108		see footnote 5
65	108		see footnote 5

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66	108		see footnote 5
67	108		see footnote 5
68	108		see footnote 5
69	108		see footnote 5
70	108		see footnote 5
71	108		see footnote 5
72	108		see footnote 5
73	108		see footnote 5
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80	108		see footnote 5
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82	37	36 - 37	37
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84	108		see footnote 5
85	108		see footnote 5
86	108		see footnote 5
87	108		see footnote 5
88	108		see footnote 5

[illegible]

Exhibit No.	Offered	Identified	Received
89	108		see footnote 5
90	108		see footnote 5
91	108		see footnote 5
92	108		see footnote 5
93	108		see footnote 5
94	35	34 - 35	see footnote 5

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[5]The transcript of testimony does not reflect the admission of these exhibits, but it is counsel's recollection that they were received, and the clerk's exhibit list so indicates.

[6]Defendant objected to the admission of these exhibits (Tr. 109), and the transcript of testimony does not reflect their admission. However, the clerk's exhibit list indicates that they were received in evidence.

[7]The clerk's exhibit list indicates that this exhibit was received in evidence.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

FREDRIC A. YERKE, JR.

Of Attorneys for Appellant

No. 22190

United States Court of Appeals

For the Ninth Circuit

ENERAL INSURANCE COMPANY OF AMERICA, a corporation,

Appellant,

vs.

OCKWOOD WATER DISTRICT, a municipal corporation,

Appellee.

Appellee's Brief

ppeal from the Final Judgment of the United States District Court for the District of Oregon

The Honorable Robert C. Belloni, Judge.

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STATEMENT OF THE CASE

Nature of the action

This is an action for a declaratory judgment brought by Rockwood Water District, a Municipal corporation (appellee) against General Insurance Company of America (appellant) to determine whether the defendant insurer is obligated under two comprehensive liability policies issued by it to Rockwood, to defend two actions brought against Rockwood, and to pay all damages and costs which Rockwood may become legally bound to pay in said actions. (R. 95)

Summary of facts

Rockwood cannot accept General's summary of the facts, as it is considered to be incomplete and contains certain inaccuracies; particularly the statement on p. 5 that, "Appellant was not notified that this action had been filed," (referring to the action of Rockwood vs. Beall Pipe & Tank Co.), and the statement on p. 6 that appellant learned of said action for the first time on October 7, 1964.

The following is a restatement of the facts which in Rockwood's view are supported by the record.

General issued two comprehensive public liability insurance policies to Rockwood, covering the period from June 1, 1962, to December 14, 1964, as set forth

on page 3 of appellant's brief, and containing the provisions, among others, quoted on page 4 thereof. The issuance of these policies came about in this way: Early in 1962, General's Portland agency, the W. R. Reed & Co., submitted a bid, along with its competitors, on Rockwood's insurance requirements. Preparatory to quoting, Reed made use of General's technical advisory service, and a technical adviser of that company made his own inquiries and investigation of the policies needed, risks involved, and loss ratio experience of the Rockwood Water District, and in the course of his investigation, ascertained that Rockwood had received complaints from some of its users of tar in the water, and that one or two of them had submitted claims for consequent damages to the water district. Agent Reed's quotation included an added premium to broaden coverage to an occurrence, rather than merely accidental basis. (Deposition of William R. Reed, pp. 5-14,Exh 26) Rockwood accepted Reed's bid and General wrote the first policy.

Between 1954 and 1961, Rockwood purchased and installed in its water system welded steel pipe, asphalt dipped and wrapped, manufactured by Beall Pipe & Tank Company, Portland, Oregon. This type of pipe had been successfully used in domestic water supply systems throughout the United States, and should have

had a reasonably expected life of 35 years. (Op. 3 & 4,[1] R 201-202; Paras. III(b) and (c), PTO, R 98, and Stipulation, Tr 29).

On February 21, 1961, one of Rockwood's water users made a claim for $2.95 for damages to clothing caused by tar particles in the water. Four claims were made, other than the Electronic's claim, prior to cancellation by defendant of its policy. These were in 1962 and 1963 and totaled $250. (Op 2, R 200; para. III (i), PTO, R 100, and Stipulation, Tr 31) In 1963, Rockwood engaged engineers to investigate the complaints about its water supply. The engineers determined that after the asphalt-coated steel pipe had been in service for from three to seven years, the interior asphalt coating started to flake and dislodge. (Op 3-4, R 201-202).

On March 1, 1963, Rockwood filed an action in the Circuit Court for Multnomah County, Oregon, against Beall Pipe & Tank Co., a corporation, No. 289869. The third amended complaint, on which the action was tried, alleged that Beall sold and delivered to Rockwood 183,560 lineal feet of asphalt coated water pipe, for which Rockwood paid $269,348; it alleged breach

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[1] The opinion of the district court is at p. 199 of the record. The opinion served as findings of law and fact under Rule 52 (a), Fed. R. Civ. P. Appellant has not challenged the findings of fact of the district court.

of a warranty of merchantability, and sought damages in the sum of $669,348. The ad damnum paragraphs of the third amended complaint are as follows:

> "VII. That the reasonable value of said water pipe when delivered to the plaintiff should have been its purchase price, namely, $269,348.08, but that by reason of the failures and breaches aforementioned, the actual value of said pipe was the sum of $100,000 and that plaintiff on account thereof suffered damages in the sum of $169,348.08.
>
> "VIII. That as a direct and proximate result of defendant's breaches of warranty and the foregoing failures, the reasonable and expected life of said water pipe has been substantially reduced; plaintiff's entire circular type water system has been depreciated in value, said system and the water therein has been fouled and choked with loose asphalt material requiring plaintiff to spend large sums in the removal of said material and in repairing and in replacing parts of its system and that plaintiff will be required to spend large sums in the foreseeable future for such removal, repair and replacement, all to plaintiff's further and special damages in the sum of $500,000.00."

There was no claim by Rockwood in said action for damages, if any, suffered by Rockwood's customers. That action was tried to the court without a jury, from October 12 to October 22, 1964, and resulted in a judgment on March 1, 1965, in favor of Rockwood in the sum of $200,000. (Op. 5, R 203, and para. 5,

Amendment & Supplement to PTO, R 194). A certified copy of the judicial record of that action is attached to the pretrial order as Exh J (R 173-192).

Electronic Specialty Company's Portland plant was not in existence on March 1, 1963, when Rockwood filed its action against Beall. That company did not complete its plant and move into it until September of 1963 (Tr 90). Electronic came to the conclusion that it had a claim against Rockwood about June 27 or 28, 1964 (Tr 81), and its attorney, Stephen Parker, notified Rockwood of Electronic's intention to claim damages against Rockwood by a letter of July 9, 1964, although the amount of damages allegedly sustained had not at that time been determined (Exh 4). On January 25, 1966, Electronic Specialty Company filed a complaint in the United States District Court for the District of Oregon against the Rockwood Water District and Beall Pipe & Tank Co., claiming $65,400 damages for alleged losses sustained to its plant equipment and products of its manufacturing process, allegedly due to asphalt particles in the water supplied it by Rockwood. That action is now pending in said court. (R 96).

Mr. and Mrs. Raymond J. Spangler on January 24, 1965, submitted a written claim to Rockwood for alleged damages to clothes and appliances, and for inconvenience (R 97). On November 4, 1965, Spanglers filed an action in the Circuit Court for Multnomah

County, Oregon, against Rockwood, which as amended claimed $6,500 damages and continuing damages, allegedly resulting from Rockwood's failure to supply the Spangler's residence with water which was safe and adequate for their domestic use (R 97). That action was compromised and settled by Rockwood, after General had denied insurance coverage and refused a tender of the defense thereof, by the payment of $400 (R 193).

The Electronic Specialty Co. and the Spangler actions are the two damage actions which the district court has held are General's responsibility.

Rockwood transmitted the Electronic and Spangler claims to General. On October 23, 1964 (the day after the evidence in Rockwood vs. Beall was closed and the cause was submitted) General wrote Rockwood as follows:

> "This is to advise you that we shall make an investigation of the claims being asserted against you by Electronics Specialty Co. However, in doing so we are expressly reserving any and all rights to deny coverage under said policy at some later date for the following reasons, among others:
>
> * * * *
>
> "If at some later date we should settle such claims or pay any judgment, it would appear that our right to subrogation against Beall Pipe & Tank Corp. has been lost by your filing of the lawsuit to which reference has been made and to proceeding to trial of such lawsuit.

* * * *

. . . " (Exh 18, which is also Exh 1 to Deposition, Exh 91).

On July 12, 1965 (over eight months after the cause was submitted in Rockwood vs. Beall), General denied insurance coverage of either the Electronic or Spangler claims (R 96, 97; Exh E of PTO, R 162).

Appellant has stated in its brief (p. 6) that, "October 7, 1964, appellant learned for the first time of appellee's pending action against Beall." There was evidence, however, that General had been informed by Attorney Stephen Parker in late September, 1964, and on other occasions prior to October 7, 1964, of the Rockwood vs. Beall case. There was also testimony by General's adjuster, Thomas Klosterman, Jr., that he may have known about that suit in late August or early September, 1964, and that counsel for Rockwood informed him about September 21, 1964, that said counsel could not open up his files to the attorneys who were counsel for General, as the same attorneys were his opponents in the Rockwood vs. Beall suit, and suggested to said adjuster that General retain independent counsel to advise them as to their rights of subrogation and the like in connection with that suit. Since the evidence is apparently disputed on the question as to just when defendant acquired knowledge of the pendency of the

Rockwood vs. Beall suit, review of that evidence will be deferred to the argument.

In the district court, General denied coverage on the following grounds (Op 3, R 201):

(1) That the claims do not fall within the policy definition of "occurrence."

(2) That the claims are within an exclusionary clause.

(3) That Rockwood failed to satisfy the "notice" requirements of the policy.

(4) That as the result of a judgment in an action by Rockwood against Beall Pipe & Tank Company, any rights to subrogation that General Insurance would have under the provisions of the policies have been prejudiced and extinguished.

(5) That by reason of the cancellation of the policy on December 14, 1964, no coverage existed as to either claim.

General's appeal questions the correctness of the district court's determination of the fourth ground above; all others have been abandoned.

Questions presented on appeal:

The appeal presents these principal questions:

1. If an insurer denies liability for a claim on specific grounds, does it waive other grounds then within its knowledge?

2. Can an insurer deny coverage under its policy and at the same time claim that its rights of subrogation were prejudiced?

3. Did the defendant insurer waive any right to subrogation by its own negligent conduct in failing to take timely action to protect its rights, if any?

4. Is a judgment in favor of a water district against a pipe manufacturer for dimunition in the value of asphalt coated pipe and depreciation of the water system in which such pipe was installed, res judicata as to future possible liability by the district to water users for damages allegedly caused by water containing asphalt particles which flaked and dislodged from the pipe?

SUMMARY OF ARGUMENT

1. By denying coverage under Rockwood's policies of the Electronic and Spangler claims on specific grounds, not including loss of subrogation rights, General waived other grounds then within its knowledge, including alleged loss of subrogation rights.

II. General cannot deny coverage under its insurance policies and at the same time claim that its rights of subrogation were prejudiced.

111. If General's rights of subrogation were prejudiced by the judgment in Rockwood vs. Beall, it was due to General's own negligent conduct in failing to take timely action to protect its rights, if any.

IV. The judgment obtained by Rockwood against Beall for loss of value of water pipe due to its shortened life and for consequential damages to Rockwood's water system is not res judicata of any cause of action of Electronic Specialty Company or Spanglers against Rockwood or Beall for damages due to water allegedly containing asphalt particles.

PROPOSITION OF LAW NO. I: BY DENYING COVERAGE UNDER ROCKWOOD'S POLICIES OF THE ELECTRONIC AND SPANGLER CLAIMS ON SPECIFIC GROUNDS, NOT INCLUDING LOSS OF SUBROGATION RIGHTS, GENERAL WAIVED OTHER GROUNDS THEN WITHIN ITS KNOWLEDGE, INCLUDING ALLEGED LOSS OF SUBROGATION RIGHTS.

POINTS & AUTHORITIES

1. If an insurer denies liability for a claim on specific grounds, it waives other grounds then within its knowledge.

29A AmJur, Insurance 262, Sec. 1098.

Ward v. Queen City Ins. Co., 69 Or 347, 352-354, 138 P 1067, 1069.

Eaid v. National Casualty Co., 122 Or 547, 557-559, 259 P 902, 906.

ARGUMENT

When General finally on July 12, 1965 (Exh E of PTO, R 162, which is also Exh 69) took a position on the Electronic and Spangler claims, it denied coverage of its policy on several grounds: That the claims did not constitute occurrences as defined in the policy; that the claims were within an exclusionary clause; and that defendant was not given timely notice of the occurrences. General's July 12, 1965, letter **did not** specify loss of subrogation rights as a ground for its refusal of liability. If the rule is applied that the insurer is limited to the grounds it did assign, its present standing to litigate its alleged loss of subrogation rights is highly questionable. 29A **AmJur Insurance** 262, Sec. 1098; **Ward v. Queen City Ins. Co.,** 69 Or 347, 352-354, 138 P 1067, 1069; **Eaid v. National Casualty Co.,** 122 Or 547, 557-559, 259 P 902, 906.

PROPOSITION OF LAW NO. II: DEFENDANT CANNOT DENY COVERAGE UNDER ITS INSURANCE POLICIES AND AT THE SAME TIME CLAIM THAT ITS RIGHTS OF SUBROGATION WERE PREJUDICED.

POINTS & AUTHORITIES

1. An insurer cannot deny coverage under its policy and at the same time claim that its rights of subroga-

tion were prejudiced. The denial of coverage relieves the insured from his obligation not to release the wrongdoer by settlement or judgment.

Anno. 49 ALR2d 694, 744.

Anno. 67 ALR2d 1086, 1087-1088.

6 Appleman, Insurance Law and Practice, Sec. 4093, Pocket Supplement.

Jaloff v. United Auto Indemnity Exch., 121 Or 187, 198, 200, 253 P 883, 887, 888 (1927).

Roberts v. Fireman's Ins. Co. of Newark, N.J., 376 Pa 99, 101 A2d 747, 750 (1954).

Otteman v. Interstate F. & Cas. Co., 172 Neb 574, 111 NW2d 97, 101, 89 ALR2d 1182 (1961).

Maryland Cas. Co. v. Employers Mut. Liability Ins. Co. (D Conn. 1953), 112 F Supp 272, 275.

ARGUMENT

In the district court, the defenses were the same as those specified in General's July 12, 1965, letter denying coverage, and the additional defense that as a result of the judgment in favor of Rockwood against Beall, defendant's rights to subrogation were prejudiced and extinguished. The denial of coverage was a repudiation of the insurance policies. The district court

disagreed with General's denial of coverage and held that the policy did afford Rockwood coverage of the Electronic and Spangler claims, and General has not appealed from that ruling. Yet, General contended, and still contends, that the policy, even though repudiated by it, was and is binding on Rockwood; that Rockwood was not free to protect its own rights.

The Supreme Court of Pennsylvania in **Roberts v. Fireman's Ins. Co. of Newark, N.J.,** 376 Pa 99, 101 A2d 747 (1954), very clearly stated the applicable rule, as follows:

> ". . . Here, the insurance company not only did not offer to pay the insureds' claim under the policy or any part of it but, as expressed by its own designated adjuster, persisted in denying liability on the ground that the loss was not covered by the insurance contract. If anyone can be said to have repudiated the policy, it was the insurer rather than the insured. Yet, the company now seeks to avoid liability under the policy by claiming that the insured violated the contract and, in so doing, extinguished the insurer's right of subrogation. The contention is manifestly without merit." (101 A2d 747 at 749-750).

The same rule has been adopted in Oregon: **Jaloff v. United Auto Indemnity Exch.,** 121 Or 187, 198, 200, 253 P 883, 887, 888 (1927). Other authorities to the same effect are: **Anno.** 49 ALR2d 694, 744; **Anno.** 67 ALR2d 1086, 1087-1088; 6 **Appleman, Insurance Law and Practice,** Sec. 4093, Pocket Supplement; **Otteman**

v. Interstate F. & Cas. Co., 172 Neb 574, 111 NW2d 97, 101, 89 ALR2d 1182 (1961); **Maryland Cas. Co. v. Employers Mut. Liability Ins. Co.** (D Conn. 1953), 112 F Supp 272, 275.

It is, therefore, unnecessary to decide whether the judgment in Rockwood vs. Beall released Beall from any liability for the Electronic and Spangler claims, because General's denial of coverage relieved Rockwood from its policy obligation, if any, not to release the wrongdoer by judgment.

PROPOSITION OF LAW NO. III: IF GENERAL'S RIGHTS OF SUBROGATION WERE PREJUDICED BY THE JUDGMENT IN ROCKWOOD VS. BEALL, IT WAS DUE TO GENERAL'S OWN NEGLIGENT CONDUCT IN FAILING TO TAKE TIMELY ACTION TO PROTECT ITS RIGHTS, IF ANY.

POINTS & AUTHORITIES

1. Where a party against whom an ultimate liability is claimed is given reasonable notice of the claim, and that the action is pending and given the opportunity to participate, if he then neglects or refuses to do so, the judgment will bind him to the same extent as if he had been made a party to the record.

Astoria v. Astoria & Columbia River R. Co., 67 Or 538, 549-550, 136 P 645, 649 (1913).

Estep v. Bailey, 94 Or 59, 68, 185 P 227, 230 (1919).

Bedal v. Hallack and Howard Lumber Company (9th Cir. 1955), 226 F2d 526, 535.

Anno. 73 ALR2d 504, 507.

2. Unreasonable delay of the insurer in processing a claim against its policy, or in determining whether it will participate in the insured's action against the wrongdoer, amounts to a denial of coverage and constitutes a waiver of its right, if any, to subrogation, thus leaving the insured free to take such action as reasonable prudence may indicate to be advisable.

Anno. 16 ALR2d 1269, 1275.

Powers v. Calvert Fire Ins. Co., 216 SC 309, 57 SE2d 638, 642, 16 ALR2d 1261 (1950).

Otteman v. Interstate F. & Cas. Co., 172 Neb 574, 111 NW2d 97, 102-103, 89 ALR2d 1182 (1961).

Poole v. William Penn Fire Insurance Company (Ala. 1955), 84 So2d 333, 336.

3. A right of subrogation is lost by inexcusable negligence on the part of the person asserting it.

Maryland Title & Escrow Corporation v. Kosisky, 245 Md 13, 225 A2d 47, 51 (1966).

Webber v. Frye, 199 Iowa 448, 202 NW 1, 2 (1925).

ARGUMENT

This proposition of law relates only to the Electronic claim, as the district court found that Spanglers did not claim damages from Rockwood until January 24, 1965, which was four months after the Rockwood vs. Beall cause was submitted to the court. Since there could be no amendment after the cause was submitted (**ORS** 16.390[1]), any question of amending to bring in the Spanglers is eliminated.

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[1] **ORS** 16.390. "The court may, at any time before trial, in furtherance of justice, and upon such terms as may be proper, allow any pleading or proceeding to be amended by adding the name of a party, or other allegation material to the cause; and in like manner and for like reasons may, **at any time before the cause is submitted,** allow such pleading or proceeding to be amended, by striking out the name of any party, or by correcting a mistake in the name of a party, or a mistake in any other respect, or when the amendment does not substantially change the cause of action or defense, by conforming the pleading or proceeding to the facts proved." (Emphasis added)

The record shows the following facts relating to the Electronic claim:

Electronic came to the conclusion that it had a claim against Rockwood about June 27 or 28, 1964 (Tr 81), and its attorney, Stephen Parker, notified Rockwood of Electronic's intention to claim damages by a letter of July 9, 1964 (R 159), at the same time dispatching a similar letter to Beall Pipe & Tank Co. (Tr 71). Not later than August 17, 1964, and probably as early as July 14, 1964 (Exhs 5 and 6), counsel for Rockwood telephoned W. R. Reed & Company, the insurance agency, advising of the Electronic claim, and this was followed by a letter of August 31, 1964 (R 96; Exhs 6 and 15). General, in its brief (p. 5), has attempted to set back to January, 1964, the time when Electronic claimed damages against Rockwood. This was when Max Sawyer, the Engineering Administrator of Electronic, telephoned the Rockwood office and complained that Electronic had tar in its water which was getting into its welding water cooling lines and that its boiler was corroded (Tr 91-92; para. II(d), PTO, R 96). General neglects to inform the court, however, that Mr. Sawyer in his testimony disclaimed having sustained any damages in January, 1964 (Tr 96), or that the trial court made a finding on this point as follows: "I find that when Rockwood first received telephone complaints they had no reason to believe that claims for

damages would arise, and when the claims did arise, Rockwood gave notice, as required by the policies." (Op 5, R 203).

Reed transmitted Rockwood's August 31, 1964, letter to General's branch claims office in Portland on September 3, 1964 (Exh 7). Mr. Thomas K. Klosterman, Jr., who was then General's adjuster, but is no longer in its employ, testified in his first deposition [1] that the first notice he had of the Electronic claim was a telephone call from Attorney Stephen Parker, "telling me if I didn't get out of my chair and get on the road I was going to be in serious trouble." "This was in the first part of October, and to be more specific, either the last of the first week or the beginning of the second week in October of 1964." (Klosterman Depo. 1-9) In his second deposition, however, Mr. Klosterman, when faced with the fact that he had set up a claims file on September 9, 1964, relating to the Electronic claim (Exh 8), had to admit that his prior testimony "is not what you call untrue or anything, but it is not correct." " . . . it appears to me that I was off just about one whole month of my prior deposition." "This actually - here I am talking about October. It actually occurred

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[1] There are two depositions of Thomas K. Klosterman, Jr., the first taken February 4, 1967, and the second April 12, 1967. They are identified herein as Klosterman Depo. I and II, followed by the page number.

in September." (Klosterman Depo. II-15) He testified this time that his first notice of the Electronic claim was a memorandum from W. R. Reed & Company of September 3, 1964. (Klosterman Depo. II-10-11).

Mr. Klosterman acknowledged that General's drive-in claims service was not up to par in this case, when he testified as follows:

(Klosterman Depo. II-11)

"Q Well, did you make an investigation, make any phone calls, or talk to anyone from Rockwood or Electronic, or an agent or anyone else before it was officially assigned?

"A No, I sat on that letter until I started getting calls from an attorney, Steve Parker. He called me twice, and he called Tom Wernette[1] the third time. An appointment was made, and we went out to Electronic Specialty Company. I did no investigating prior to that time."

He also acknowledged that during the five weeks during which he "sat on that letter" he had telephone calls from Rockwood's counsel, as well as from Mr. Parker (Klosterman Depo. II-11, and Exh 9).

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[1] Tom Wernette was Claims Manager of General's Portland branch office.

Regarding notice of the pendency of the Rockwood vs. Beall case, Mr. Klosterman testified as follows: (Klosterman Depo. I-25-27)

"Mr. St. Martin: Q Do you recall a conversation with me prior to the Rockwood trial in which I suggested that you, your company retain the services of an attorney to advise you about subrogation and the like because we were going to trial, and that you would be reporting to your superiors?

* * * *

"The Witness: I do recall your telling me this, Joe, but, of course, to recollect on the time angle - yes, I do recall your telling me this.

* * * *

"Q Do you recall my telling you in our first conversations that I would not turn over confidential information to the Mautz, Souther firm because they were defending Beall?

"A I remember this, Joe. Yes, I do."

As to the time of the conversations just referred to, Mr. Klosterman first testified that the conversations took place during the trial of Rockwood vs. Beall (Klosterman Depo. I-28). He acknowledged, however, that he could be mistaken on the time (Klosterman Depo. I-29). In his second deposition, however, he testified that he recalled meeting Rockwood's counsel in the courthouse coffee shop **about September 21, 1964,**

and discussing the matter of the Rockwood vs. Beall suit, at which time Mr. St. Martin gave him the title of the case and copies of some of the pleadings. He further testified regarding that suit as follows:

(Klosterman Depo. 11-8)

"Q I take it that your testimony is that you knew on September 1st that we were going to trial or would be but didn't know the exact date?

"A If this meeting of ours was on the 21st, **it is possible that I knew about the trial in early September or late August** through a previous phone call or meeting. As I recall, we met one time prior to our meeting at the courthouse to discuss the matter, and I am sure I was aware at that time that we were going to trial."

On cross examination, he testified as follows:

(Klosterman Depo. 11-19)

"Q Isn't it a fact that actually you learned of the pendency of the Rockwood versus Beall lawsuit at the conference at Electronic Specialty on October 7th and that after leaving that meeting you and Messrs. Wernette and Carson decided to call me the next day and retained me because of the fact that you had learned of the lawsuit? Don't you recall that?

"A **I recall our discussion and our coming over here to retain you because Mautz was involved with Beall Pipe & Tank Company.** I don't recall on that particular date their mentioning anything

about their lawsuit, but of course, it is possible that my superior made this up. It is possible that it was his main concern at the time. It is possible that Joe and I met at the Courthouse after this day."

Rockwood's request that General retain independent counsel was renewed at a later date, as shown by Mr. Klosterman's further testimony as follows:

(Klosterman Depo. 11-24)

"Q Do you recall the conversation in front of the Hilton Hotel at a later date?

* * * *

"A One of the things I recall is that you were not going to deal with me but only with my attorney. You didn't want to - you were not going to open your file to us. You would give our attorney some information.

"Q Was it also stated to you that no attorney had contacted me at that date as yet, and renewal of the request was made for you to retain counsel?

"A I think that is correct."

A disinterested witness, Stephen Parker, in his testimony confirmed that General had notice of the Rockwood vs. Beall case at least by late September of 1964. Mr. Parker testified that he had learned in July, 1964, in talking with the attorneys for Beall and Rockwood,

of the lineup of the insurance carriers that might be involved in the Electronic case (Tr 73). He arranged for James Bruce (of the Mautz firm) and James Burns, the attorneys for Beall, and the attorneys for Rockwood, and agents of General to view the Electronic plant. Mr. Parker further testified as follows:

(Tr 78)

"Q When did you communicate this invitation to the General people?

"A I would say that I did it late in September of 1964.

"Q Did you explain to him the reason for inviting them?

"A Yes, I did.

"Q Did the matter of an impending trial, that is, to-wit, the Rockwood-Beall trial, come up in your discussions with the General people?

"A According to my memory, it did, because I recall prefacing my conversation with Mr. Wernette by saying that, 'Both sides in Rockwood vs. Beall have asked to see our plant, and I'm making arrangements for that purpose'. I selfishly said, 'I'd like to have you come out to try to orient you to the case that I have on behalf of Electronics against either Rockwood or Beall or both.'

The meeting of October 7, 1964, at the Electronics plant then took place. This is the date on which General claims in its brief (p. 6) that it "learned for the first

time of appellee's pending action against Beall." This assertion is taken from General's reservation letter of October 23, 1964, signed by Thomas E. Wernette, Claims Manager (Exh 18). General in its brief also cites in support of that date a memorandum written by Mr. Klosterman to Mr. Bachtel, N.W.D.-Claims on October 17, 1964 (Exh 16), and the first deposition of Mr. Klosterman. It conflicts, however, with the second deposition of Mr. Klosterman and with the testimony of Mr. Parker and it is noted that General did not put Mr. Wernette on the witness stand after Mr. Klosterman's second deposition. One other item of evidence confirms that it was about September 21, 1964, that Mr. Klosterman and counsel for Rockwood discussed the Rockwood vs. Beall suit. As shown by Mr. Carson[1]'s notes of the October 7, 1964, meeting (Exh 13), Mr. St. Martin did not attend that meeting; therefore his conversations with Mr. Klosterman had to be prior to that date.

To summarize the salient facts: Rockwood's August 31, 1964, notice letter was received in General's Portland claims office on September 4, 1964, but the adjuster testified that he did no investigating prior to October 7, 1964. Before October 7, 1964, General's adjuster received two calls from Attorney Stephen

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[1] Mr. Carson was manager of the Portland branch claims office.

Parker, and he also had calls from Rockwood's counsel, as well as at least three meetings with him. Mr. Parker also called Thomas Wernette, the Portland Claims Manager. Not later than about September 21, 1964 (20 days before the Rockwood vs. Beall trial), Rockwood's counsel suggested to the adjuster that his company retain independent counsel to advise them as to subrogation and the like in connection with that suit. General did retain counsel not involved in the Beall suit, but, according to its agent, Mr. Wernette, not until October 8, 1964. General made no attempt to dispute the reason assigned by Mr. Klosterman in his testimony, "because Mautz was involved with Beall Pipe & Tank Company." Not until Rockwood vs. Beall trial was concluded did General do anything with reference to that suit, nor did it offer any suggestions to Rockwood as to what it considered would be a proper course of action on Rockwood's part. The day after that trial was concluded, General wrote Rockwood advising that it would make an investigation of the Electronic claim, but that it was reserving the right to deny coverage at some later date for the reason, among others stated in the letter, that "it would appear that our right to subrogation against Beall Pipe & Tank Corp. has been lost by your filing of the lawsuit to which reference has been made and to proceeding to trial of such lawsuit." Finally, on July 12, 1965, over eight months after the Rockwood vs. Beall cause was submitted

to the court and over four months after judgment was entered therein, General denied covrage of the Electronic claim.

It is Rockwood's position that the Electronic claim was not involved in any way in Rockwood's action against Beall, and that such claim is not affected by the judgment therein. Nevertheless, if General considered that it had rights of subrogation which required protection, it had ample time and opportunity, before trial , to take whatever measures it might have deemed appropriate to assert its claims. The remedy, if any was needed, therefore, lay in General's hands.

Moreover, it is undisputed that General was specifically requested by Rockwood's counsel to retain an attorney not involved in the Rockwood vs. Beall suit to advise it as to subrogation and the like. This request was not an acknowledgment that General had any rights of subrogation affected by that suit, but rather a recognition that General might claim to have. The time of this request apparently is disputed, but a reasonable conclusion to be drawn from the evidence is that the request was made not less than 20 days before trial, and the evidence is plain enough that General had knowledge of the Rockwood vs. Beall suit long before that. Also, when the first request produced no response, and the trial date was nearing, the request was renewed.

In **Astoria v. Columbia River R. Co.,** 67 Or 538, 136 P 645 (1913), the Supreme Court of Oregon said:

> " 'It is sufficient that the party against whom ultimate liability is claimed is fully and fairly informed of the claim and that the action is pending with full opportunity to defend or to participate in the defense. If he then neglects or refuses to make any defense he may have, the judgment will bind him in the same way and to the same extent as if he had been made a party to the record.' This doctrine was approved by the Supreme Court of the United States in Washington Gaslight Co. v. District of Columbia, 161 US 316 (40 LEd 712, 16 SupCtRep 564)." (67 Or 538 at 549; 136 P 645 at 649).

To the same effect: **Estep v. Bailey,** 94 Or 59, 68, 185 P 227, 230 (1919); **Bedal v. Hallack and Howard Lumber Company** (9th Cir. 1955), 226 F2d 526, 535; **Anno.** 73 ALR2d 504, 507.

This principle of law could be held to make the judgment in Rockwood vs. Beall conclusive against General to the same extent as though it had been a party to that case. General's advice in its brief on appeal (p. 21) as to what it would have considered a proper course of action on Rockwood's part prior to trial of the Beall suit, is somewhat tardy. It is noted that, although General cites no authority to support either course of action it now suggests Rockwood should have taken, it criticizes the lack of citation of authority for the

trial court's holding that Rockwood had done nothing to prejudice General's rights of subrogation.

An insurer may by implication from its conduct waive any right to subrogation. Thus, in **Powers v. Calvert Fire Ins. Co.,** 216 SC 309, 57 SE2d 638, 16 ALR2d 1261 (1950), where the insurer passively or negligently failed to take any action on the insured's claim for collision insurance on his automobile which was demolished in an accident, despite numerous telephone calls by the insured to the insurer's agent, and equally numerous promises in response, as a consequence of which the insured made a settlement with the wrongdoer, the Supreme Court of South Carolina commented on the insurer's defense of loss of subrogation rights as follows:

> "An insurer will not be permitted to profit from such a course of conduct. It cannot sit down and hold its hands and purse and thereafter escape liability for fulfillment of its contract by reason of the insured's effort, after fair notice, to recoup his loss by litigation against a wrongdoer. Appellant asserts that its right of subrogation has been destroyed by the voluntary act of the insured, but the right did not survive the recited conduct of appellant which amounted at least to waiver . . .
>
> " . . . It would be highly inequitable under the facts of this case to allow appellant to shield itself from liability upon its contract obligation by the ghost of a formerly available right of subrogation . . . ." (57 SE2d 638 at 642)

Other authorities for holding that under the facts such as those in the case at bar the insurer's unreasonable delay in taking action on the insured's claim after notice amounts to a denial of coverage and a waiver of subrogation rights are: **Anno.** 16 ALR2d 1269, 1275; **Otteman v. Interstate F. & Cas. Co.,** 172 Neb 574, 111 NW2d 97, 102-103, 89 ALR2d 1182 (1961); **Poole v. William Penn Fire Insurance Company** (Ala. 1955), 84 So2d 333, 336.

Another principle of law is invoked by the facts disclosed by the evidence: "The fact that the loss of one who seeks to be made whole by subrogation arose from his own negligence may be fatal to his claim." **Maryland Title & Escrow Corporation v. Kosisky,** 245 Md 13, 225 A2d 47, 51 (1966); **Webber v. Frye,** 199 Iowa 448, 202 NW 1, 2 (1925).

PROPOSITION OF LAW NO. IV: ROCKWOOD'S PRIOR JUDGMENT AGAINST BEALL IS NOT RES JUDICATA OF RIGHTS OF ROCKWOOD OR ITS INSURER TO BE INDEMNIFIED BY BEALL FOR CLAIMS OF THIRD PARTY USERS AGAINST ROCKWOOD IN ABSENCE OF PAYMENT OR ADMISSION OF LIABILITY BY ROCKWOOD FOR USERS CLAIMS.

POINTS & AUTHORITIES

1. A cause of action must exist before an action can be commenced, and its existence or nonexistence is dependent upon the state of facts existing when the action was begun, not at some subsequent time.

1 AmJur2d, Actions 590, Sec. 58; p. 616, Sec. 87.
Freeman on Judgments (5th ed) 1510, Sec. 716.
City of Reedsport v. Hubbard, 202 Or 370, 384, 274 P2d 248, 254 (1954).

2. A judgment cannot operate as a bar of rights which did not accrue until after the action was brought.

Restatement, Judgments, Sec. 54.

Freeman on Judgments (5th ed) 1258, Sec. 597.

Hunter v. Roseburg, 80 Or 588, 598-599, 156 P 267, 270, 157 P 1065 (1916).

3. The doctrine of res judicata is confined to the issues as tendered by the pleadings, and does not extend to matters which might have been litigated under issues formed by additional pleadings.

30A AmJur, Judgments 422, Sec. 375.

4. Leave to intervene may be granted an indemnitor in the exercise of sound discretion, but not as a matter of right, even during trial, if the indemnitor has interests to protect.

ORS 13.130.

Barendrecht v. Clark, ...Or........, 83 OrAdvSh 409, 411-413, 419 P2d 603, 604-605 (1966).

5. A new and distinct lawsuit should never be injected into a case by supplemental pleading.

United States v. Southern Pac. Co. (D. Ore 1947), 75 F Supp 336, 339.

6. The Oregon Code of Civil Procedure contemplates that the issues be determined as they are presented for adjudication between the original parties to an action. It is only when they cannot be determined without prejudicing the rights of others, that other parties can be brought in by the court.

ORS 13.110.

Tichenor v. Coggins, 8 Or 270, 271-272 (1880).

Continental Guar. Corp. v. Chrisman, 134 Or 524, 530, 294 P 596, 598 (1930).

McGilchrist v. Fiedler, 155 Or 616, 621, 65 P2d 388, 390 (1937).

Brune v. McDonald, 158 Or 364, 371-373, 75 P2d 10, 13 (1938).

State Highway Com. v. Superbilt Mfg. Co., 200 Or 478, 482, 266 P2d 1072, 1074 (1954).

Union High Dist. No. 2 v. LaClair, 218 Or 493, 495-497, 344 P2d 769, 770-771 (1959).

7. Payment of the debt for which another is primarily responsible is essential to a claim of subrogation.

Furrer v. Yew Creek Logging Co., 206 Or 382, 388, 292 P2d 499, 502 (1956).

Hult v. Ebinger, 222 Or 169, 190, 352 P2d 583, 592 (1960).

8. If a consumer recovers damages from a distributor, caused by a defective product purchased from the distributor, the distributor has a prima facie right of indemnification from the manufacturer of such product.

5 Williston on Contracts (Rev. ed 1937), Sec. 1355.

3 Williston on Sales (Rev. ed 1938), Sec. 614a.

Pipe Welding Supply Co. v. Gas Atmospheres, Inc. (N.D. Ohio, E.D. 1961), 201 F Supp 191.

9. A considerable body of judicial opinion allows a distributor to recover anticipatory damages from his manufacturer for the distributor's possible liability to consumers for selling and furnishing them a defective product, which has or may cause harm to them; but the

decisions are in conflict as to when anticipatory damages can be allowed.

Allowing anticipatory indemnification

Randall v. Raper, Q.B. 4 Jur (N.S.) 662, El. B. & El. 84, 89-91, 120 Eng Rep 438, 440-441 (1858)

Buckbee v. P. Hohenadel, Jr. Co., (7th Cir., 1915), 224 F 14, 23, LRA 1916C 100.

Fred Wolstenholme v. Jos. Randall & Bro., 295 Pa 131, 144 A 909, 910 (1929).

Cohan v. Associated Fur Farms, 261 Wis 584, 53 NW2d 788, 794 (1952).

W. S. Rockwell Co. v. Lindquist Hardware Co., 143 Conn 684, 125 A2d 173, 174 (1956).

Somerville Container Sales v. General Metal Corp., 39 NJ Super 348, 120A2d 866, 872-873 (1956), modified 39 NJ Super 562, 121 A2d 746.

Allowing anticipatory indemnification but restricting recovery to cases meeting rigid standards

Superwood Corporation v. Larson-Stang, Inc. (8th Cir., 1963), 311 F2d 735, 740.

Southern Arizona York Refrigeration Co. v. Bush Mfg. Co. (9th Cir., 1964), 331 F2d 1, 6.

Grummons v. Zollinger (7th Cir., 1965), 341 F2d 464, 465.

Boyce v. Fowler (D. Mass., 1949), 87 F Supp 796, 799.

10. There is, however, a considerable body of judicial opinion refusing to adopt the rule of possible liability and restricting indemnification to those instances where the distributor's liability to his consumers has been adjusted, adjudicated, or paid.

Sewall Paint & Glass Co. v. Booth Lumber & Loan Co. (TexCivApp 1931), 34 SW2d 650, 654, affd (TexComApp 1932), 50 SW2d 793.

Liberty Mut. Ins. Co. v. J. R. Clark Co., 239 Minn 511, 59 NW2d 899, 904-905 (1953).

The Gray Line Co. v. The Goodyear Tire & Rubber Co. (9th Cir., 1960), 280 F2d 294, 301-303.

Pipe Welding Supply Co. v. Gas Atmospheres, Inc. (N.D. Ohio, E.D., 1961), 201 F Supp 191, 202.

Aetna Freight Lines, Inc. v. R. C. Tway Company (Ky 1961), 352 SW2d 372, 373-374.

Friedman v. Typhoon Air Conditioning Co. (E.D. N.Y., 1962), 205 F Supp 22, 24-26.

11. There must be an identity of parties in the two actions, between whom the rules of res judicata are claimed to be effective, before the doctrine of res judicata may be applied.

Restatement, Judgments, Secs. 79 and 96, Comment a.

30A AmJur, Judgments 447, Sec. 397.

Freeman on Judgments (5th ed) 1193, Sec. 562.

Morrison v. Holladay, 27 Or 175, 180, 39 P 1100, 1102 (1895).

Parkersville District v. Wattier, 48 Or 332, 336, 86 P 775, 776 (1906).

Bartholmae Oil Corp. v. Booth, 146 Or 154, 162, 28 P2d 1083, 1085 (1934).

Storm v. Nationwide Mutual Ins. Co., 199 Va 130, 97 SE2d 759, 761-764, 69 ALR2d 849 (1957).

12. Where several claims arise out of the same transaction, separate suits may be brought for each liability as it accrues, since the same transaction or state of facts may give rise to distinct or successive causes of action. A judgment on the first will not be a bar to the second.

ORS 11.030.

1 AmJur2d, Actions 650, Sec. 131.

Freeman on Judgments (5th ed) 1242, Sec. 588.

Sewall Paint & Glass Co. v. Booth Lumber & Loan Co. TexCivApp 1931), 34 SW2d 650, 653, affd (TexComApp 1932), 50 SW2d 793.

13. Injury or damage is an essential element of a cause of action at law. If an act is not legally injurious until damage or loss is sustained as a consequence thereof, no cause of action accrues until the loss or damage occurs.

1 AmJur2d, 596, Sec. 66; p. 617-618, Sec. 88.

Berry v. Branner, ... Or ....,83 OrAdvSh 757, 761-765, 421 P2d 996, 998-1000 (1966).

ARGUMENT

A cause of action must exist before an action can be commenced, and its existence or nonexistence is dependent upon the state of facts existing when the action was begun, not at some subsequent time. **1 AmJur2d,** Actions, 590, Sec. 58; p. 616, Sec. 87; **Freeman on Judgments** (5th ed) 1510, Sec. 716; **City of Reedsport v. Hubbard,** 202 Or 370, 384, 274 P2d 248, 254 (1954). A judgment cannot operate as a bar of rights which did not accrue until after the action was brought. **Restatement, Judgments,** Sec. 54; **Freeman on Judgments** (5th ed) 1258, Sec. 597; **Hunter v. Roseburg,** 80 Or 588, 598, 599, 156 P 267, 270, 157 P 1065 (1916). The doctrine of res judicata is confined to the

issues as tendered by the pleadings, and does not extend to matters which might have been litigated under issues formed by additional pleadings. 30A **AmJur,** Judgments 422, Sec. 375. Applying these rules to the facts here, that Rockwood filed its action on March 1, 1963, and that the Electronic plant was not in existence at that time, the conclusion is inescapable that the judgment in Rockwood vs. Beall is not res judicata as to any cause of action of Electronic against Rockwood or Beall, unless Rockwood had a mandatory duty to amend and supplement its complaint against Beall so as to plead a right to recover Electronic's alleged damages which had arisen while Rockwood vs. Beall suit was pending.

Considering that when the time was opportune to make known its views, that is, before trial of Rockwood vs. Beall, General maintained a stony faced silence, it may be pertinent to inquire what course of action was available to General, before discussing Rockwood's duty, if any. In **Barendrecht v. Clark,** ....Or........, 83 OrAdvSh 409, 419 P2d 603, General Insurance Company of America filed a motion in the Supreme Court of Oregon to intervene in an appeal pending in that court. The Oregon court held that **ORS** 13.130[1] did not preclude the belated motion, and said:

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[1] **ORS** 13.130: "At any time before trial any person who has an interest in the matter in litigation may, by leave of court, intervene . . . . "

"Adopting this interpretation, we find no obstacle in granting the petition for intervention if General, as an indemnitor, has standing to invite our examination of its alleged interest." (83 OrAdvSh 409 at 412, 419 P2d 603 at 605)

It is thus established that General could have filed a motion or petition to intervene in Rockwood vs. Beall, addressed to the sound discretion of the trial court. True, it is quite doubtful that grounds existed to incline the court favorably toward such an application, for reasons next to be discussed, but the remedy, if any was needed, lay in General's hands.

General contends, for the first time on appeal,[1] that when Rockwood received notice from Electronic in July, 1964, of Electronic's intention to claim damages, Rockwood should have filed an amended complaint for a declaratory judgment, declaring its rights against Beall as a result of the Electronic claim. In the absence, however, of any request or even suggestion from General that it do so, Rockwood had no duty to amend or supplement its complaint against Beall in any way, for the following reasons:

---

[1] If there should be any doubt that this contention is advanced for the first time on appeal, the court has the power to direct that the briefs submitted to the trial court be sent up.

(1) Rockwood had no right to amend and supplement, bringing in a new party with a new and distinct cause of action. The applicable rule was stated by the late Judge Fee in **United States v. Southern Pac. Co.** (D. Ore 1947), 75 F Supp 336, 339, as follows:

> " . . . A new and distinct lawsuit should never be injected into a case by filing a supplemental pleading. This rule is inherent in all systems of pleading, common law, code or federal. It is required by the necessities. Confusion would otherwise result . . . "

The Supreme Court of Oregon, construing **ORS** 13.110[1], has held in a series of not less than six decisions, beginning with **Tichenor v. Coggins,** 8 Or 270, 271-272(1880) through **Union High Dist. No. 2 v. LaClair,** 218 Or 493, 495-497, 344 P2d 769, 770-771 (1959), that the Ore gon Code of Civil Procedure contemplates that the issues be determined as they are presented for adjudication between the original parties to an action, and that it is only when they cannot be determined without prejudicing the rights of others, that other parties can be brought in by the court.

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[1] **ORS** 13.110. "In actions or suits the court may determine any controversy between parties befored it, when it can be done without prejudice to the rights of others, or by saving their rights; but when acomplete determination of the controversy can not be had without the presence of other parties, the court shall cause them to be brought in."

(2) It would be unreasonable to expect Rockwood to stir up litigation against itself, especially when it has always denied any liability to Electronic, and in the pending action of Electronic vs. Rockwood and Beall, is vigorously disputing any liability. It is to be recalled that Electronic gave notice of alleged breach of warranty on July 9, 1964, but did not file its action against Rockwood and Beall until January 25, 1966. In the meantime, Rockwood had strong grounds to believe that Electronic had abandoned its claim.

General next contends that an insurer's rights of subrogation are derived from the insurer's right to recover against the wrongdoer. That Rockwood had a right to recover from Beall its possible future contingent liabilities to its users, such as Electronic and Spanglers, resulting from the failure of the asphalt pipe lining, which in turn may have at times caused the water distributed by Rockwood to contain asphalt particles. General draws the conclusion from these premises that such possible future contingent liabilities could have been included in Rockwood's claims of damages in its action against Beall, and since they were not, that the judgment therein is res judicata as to any such liability.

Before turning to the authorities of the law, it might be pertinent to explore briefly the significance of General's contention.

Does General contend that Rockwood's attorneys should have knocked on every door of the 8,400 families and businesses in the district, to encourage them to submit claims for damages against Rockwood or its insurer? The race to join in the raid on Rockwood's public treasury can well be imagined. If this were done, should the individual claimants have been joined as parties in the action against Beall? What would be the effect on any not joined, or those who had no claims at that time, but did sustain damages at some subsequent time? Or, perchance, does General contend that Rockwood should have included a claim for a slush fund in its action against Beall, to cover possible future liability to its users? If the obstacle of speculative damages could be hurdled in the action against Beall, what is General's solution if the fund should prove too small? Or too large?

If a consumer recovers damages from a distributor, either by adjudication and payment or voluntary adjustment and payment, for the consumer's loss due to a defective product purchased from the distributor, the distributor has a prima facie right to claim idemnification from the manufacturer. The consumer's claim for damages in the event of such payment is then owned by the distributor. Rockwood, however, has never made any payment to Electronic; thus has never become subrogated to Electronic's rights, if any, against Beall. The Oregon court has consistently held that payment of the

debt for which another is primarily responsible is essential to a claim of subrogation. **Furrer v. Yew Creek Logging Co.,** 206 Or 382, 388, 292 P2d 499, 502 (1956); **Hult v. Ebinger,** 222 Or 169, 190, 352 P2d 583, 592 (1960). It follows that Rockwood could not attempt to recover in its action against Beall the damages, if any, sustained by Electronic.

Some courts have held, however, that something less than payment will suffice upon which to ground a claim of indemnity. The fountainhead of the law on this subject is **Randall v. Raper,** Q.B. 4 Jur. (N.S.) 662, El. B & El. 84, 120 Eng Rep 438 (1858). In that case plaintiffs, seed merchants, brought action to recover their own damages, as well as those of four farmers, to whom plaintiffs had sold barley seed, passing on to the subvendees a warranty of quality similar to the grower's warranty given to plaintiffs. The seed turned out to be not as warranted; it produced inferior crops. The four farmers made claims upon the plaintiffs, who agreed to satisfy them, but no amounts were fixed. There was a judgment for plaintiff by default, and on hearing on a writ of inquiry to assess the damages, the damages of the plaintiffs and those of the four purchasers from them were proved, and verdict entered thereon. This was upheld by the Queen's Bench. Erle, J., in one of the four opinions of the judges, said:

"But then it is said that here the plaintiffs have

> made no actual payment; so that, if they recovered such damages in this action, they might put them into their own pockets without paying the sub-vendees. But I think that the true rule is, that a liability to loss is sufficient to give the party a title to recover." (El. B. & El. 84 at 90; 120 Eng Rep 438 at 441)

With recent developments in the law of product liability, marked by the discarding of the necessity of privity of contract in warranty actions, and the imposing of strict liability in tort actions, there has been a tendency to overlook that **Randall v. Raper** involved a few known consumers and required actual legal liability and proven damages. A considerable body of judicial opinion has accumulated, extending the distributor's right of indemnification to cases of anticipatory damages, that is, where the distributor has not adjusted or paid any claims of his consumers, but is seeking indemnity from his manufacturer for possible losses. The decisions are in conflict as to when anticipatory damages can be allowed. One writer has classified the precedents in three catagories, as follows:

> (1) Allowing the distributor to recover from the manufacturer damages for the probable, natural and necessary consequences of the allegedly defective product, without attempting to establish the standards;
>
> (2) Refusing to adopt the rule of probable liability, and restricting recovery to those instances where the distributor's liability to his consumers has been adjusted, adjudicated, or paid; and

(3) Allowing anticipatory indemnification, but requiring that actual legal liability be established; not nebulous, uncertain, or speculative, but foreseeable, reasonable, and subject to calculation.

Some of the decisions are collected in Points 9 and 10 of the Points and Authorities, p. 33 hereof, but this is not an exhaustive collection.

It can well be doubted whether the rule of anticipatory indemnification is applicable at all in a situation where the identity and number of possible claimants is unknown, where the distributor does not admit but disputes liability to the consumer, or where, as pointed out in **Superwood Corporation v. Larson-Stang, Inc.** (8th Cir., 1962), 311 F2d 735, 739, the manufacturer's product is not resold as such. It is scarcely necessary, however, to reach the question of the applicability of the rule of anticipatory indemnification, or some modification thereof, as the Electronic claim was a new and distinct cause of action, arising during pendency of Rockwood's action against Beall.

Cohan v. Associated Fur Farms, 261 Wis 584, 53 NW2d 788 (1952), relied on by General, applied the rule of probable liability to the facts in that case so as to render the distributor's (Associated's) action against the manufacturer (Armour) for loss of the distributor's own mink due to feeding them contaminated animal food obtained from the manufacturer (Armour)

res judicata as to the consumer's (Cohan's) action against the distributor (Associated), where the distributor had not sought recovery of its probable liability for its consumer's damages in its action against the manufacturer. This case is sharply distinguishable, however, from the present case in these respects:

(1) In the **Cohan** case, the consumer's cause of of action had accrued before the distributor had brought action to recover its own damages from the manufacturer; while here the consumer's (Electronic's) plant was not even in existence when Rockwood sued to recover its own damages from Beall.

(2) The distributor (Associated) attempted to mislead and deceive the consumer (Cohan) when the consumer complained to the distributor of the death of his mink. The distributor denied loss of mink due to food contamination but thereafter filed a case against Armour for the loss of its own mink.

(3) The liability of the distributor (Associated) to the consumer (Cohan) in some amount apparently was not disputed, as the distributor cross-complained against the manufacturer, seeking recovery of the consumer's (Cohan's) damages in the event the distributor was held responsible to the consumer; whereas the liability of Rockwood to Electronic has always been disputed.

General's argument overlooks that there must be an identity of parties before the doctrine of res judicata may be applied. As set forth in **Restatement, Judgments,** Sec. 96, Comment a, a person is not entitled to

litigate the same issue **with the same adversary** in more than one action. To the same effect: 30A **AmJur,** Judgments 447, Sec. 397 **Freeman on Judgments** (5th ed) 1193, Sec. 562; **Morrison v. Holladay,** 27 Or 175, 180, 39 P 1100, 1102 (1895); **Parkersville District v. Wattier,** 48 Or 332, 336, 86 P 775, 776 (1906); **Bartholmae Oil Corp. v. Booth,** 146 Or 154, 162, 28 P2d 1083, 1085 (1934); **Storm v. Nationwide Mutual Ins. Co.,** 199 Va 130, 97 SE2d 759, 761-764, 69 ALR2d. 849. Also, whatever the rule may be elsewhere, in Oregon a cause of action does not accrue until a person discovers that he has sustained damage. **Berry v. Branner** .... Or ...., 83 OrAdvSh 757, 761-765, 421 P2d 996, 998-1000 (1966). When Electronic's cause of action accrued in July of 1964, it was a new and distinct cause of action, and not an additional element of Rockwood's damage, as contended for by General, for which it cites several authorities involving quite dissimilar situations. The common law rule applicable here is codified in Oregon by **ORS** 11.030, as follows:

> "Successive actions or suits may be maintained upon the same contract or transaction, whenever, after the former action or suit, a new cause of action or suit arises therefrom."

Illustrative of this rule is **Sewall Paint & Glass Co. v. Booth Lumber & Loan Co.** (TexCivApp 1931), 34 SW2d 650, affd (TexComApp 1932), 50 SW2d 793, where the Lumber Company claimed indemnification from

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOSEPH D. StMARTIN,
Of attorneys for appellee.

No. 22190

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

AL INSURANCE COMPANY OF AMERICA,
poration,

Appellant,

v.

OOD WATER DISTRICT, a municipal
ration,

Appellee.

APPELLANT'S REPLY BRIEF

peal from the Final Judgment of the United States
District Court for the District of Oregon

THE HONORABLE ROBERT C. BELLONI, Judge

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:orporation,

Appellant,

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:KWOOD WATER DISTRICT, a municipal
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APPELLANT'S REPLY BRIEF

Appeal from the Final Judgment of the United States
District Court for the District of Oregon

THE HONORABLE ROBERT C. BELLONI, Judge

PRELIMINARY STATEMENT

Appellee has opened its brief with a lengthy dis-
ssion of purported facts (appellee's brief, pages 1-8).

The issue in this case is one of law. Therefore, pellant does not deem any further factual discussion to be cessary, and for the relevant factual framework it refers e court to the statement of facts in its opening brief ppellant's brief, pages 3-8).

ARGUMENT

Appellee has failed to refute appellant's showing that e District Court erred when it held that appellee's judgment inst Beall did not prejudice or render valueless appellant's ght of subrogation.

To summarize, appellant showed the court in its ening brief that (1) the judgment appellee obtained against all destroyed or rendered valueless appellant's right of progation in any future proceeding against Beall because of e defense of res judicata, and (2) accordingly, appellee by s own conduct has destroyed its rights, if any, under the licies.

Appellee has attempted to refute appellant's showing four arguments, which may be summarized as follows:

1. Appellant may not assert the loss of its subrogatio rights because of (a) the contents of a letter dated July 12, 1965, denying coverage (appellee's brief, pages 10-11) and (b) the fact that appellant denied coverage (appellee's brief, pages 11-14);

2. The loss of appellant's subrogation rights resulte from its failure to take action to protect such rights (appellee's brief, pages 14-29); and

3. Appellee's judgment against Beall is not res judicata of the claims involved in this case (appellee's brief, pages 30-48).

These arguments will be discussed and exposed seriatim.

1. <u>Contents of letter dated July 12, 1965</u>

Relying on a letter dated July 12, 1965, appellee con-
nds that (1) appellant denied coverage on specified grounds,
including loss of subrogation rights, and (2) as a result,
waived the right to rely on its loss of subrogation rights.

In this connection, the facts are as follows:

By letter dated October 23, <u>1964</u>, appellant advised
pellee that the latter's action against Beall was prejudicial
appellant's right of subrogation against Beall (Ex 1 to Ex 91):

> "If at some later date we should settle such claims or pay any judgment, it would appear that our right to subrogation against Beall Pipe & Tank Corp. has been lost by your filing of the lawsuit to which reference has been made and to proceeding to trial of such lawsuit."

The letter dated July 12, 1965, referred to by
pellee, stated in part as follows (R 162):

> "Occurrences, as defined in the policy are covered by the policy. However, 'occurrences' as defined in the policy refer to 'unexpected' happenings or exposures. It is apparent that the Spangler and Electronic Specialty Company claims do not fall in this category inasmuch as they were preceded by a number of similar claims extended over a period of some years. In addition, we were not given timely notice of the occurrences as required by conditions of the policy. Further, there is no coverage for losses caused by improper performance or nonsuitability for its intended purpose of goods or products.
>
> "It is our position, therefore, that for the foregoing reasons, <u>among others</u>, no coverage exists for those two claims under the subject policy." (Emphasis added)

As authority for its argument, appellee relies on

Am Jur, Insurance, Section 1098, pages 262-263

ch provides as follows:

> "There are many cases asserting the rule that where an insurer denies liability for a loss on one ground, at the time having knowledge of another ground of forfeiture, it cannot thereafter insist on such other ground if the insured has acted on its asserted position and incurred prejudice or expense by bringing suit, or otherwise. No waiver or estoppel results, however, where the ground of forfeiture not asserted is one which could not have been cured by the insured, or where no prejudice results to the claimant from reliance on the statement of the insurer. Furthermore, the rule does not apply to grounds of objection not known to the insurer, nor does it apply if the denial of liability is accompanied by a reservation of defenses other than those specified." (Emphasis added)

Appellee also relies on two Oregon cases,

Ward v. Queen City Ins. Co.
(1914) 69 Or 347, 138 Pac 1067

and

Eaid v. National Casualty Co.
(1927) 122 Or 547, 259 Pac 902

Neither of these cases detract from the above quoted

tement from American Jurisprudence; in fact, both confirm

same.

Thus, in the Ward case (1) the insurer denied liability

the sole ground that the insured had increased the hazard of

risk and (2) the insured accepted this as the sole ground for

insured's denial of liability, and in reliance on this

tement changed his position to his prejudice. The court

ted (69 Or 352-353, 138 Pac 1068):

> "After the lapse of some months subsequent to the fire, defendant expressed its declination to meet the terms of the contract of insurance upon the sole ground that certain acts of the plaintiff had increased the hazard of its risk. Accepting this position of defendant's as the battleground, plaintiff employed counsel and initiated this action. By this conduct, defendant led plaintiff to believe that there was but one reason for its denial of liability; consequently, under such circumstances, defendant should not be permitted to screen itself from liability on grounds other than the one specified in the letter indited by its legal representative, provided defendant had informed itself prior to the letter of the cause of the fire, and was in possession of the material which it now claims exculpates it from liability. 'Every consideration of public policy demands that insurance companies should be required to deal with their customers with entire fairness and frankness. They may refuse to pay without specifying any ground, and insist upon any available ground, but, when they plant themselves upon a separate defense and so notify the insured, they should not be permitted to retract if the latter has acted upon their position as announced, and incurred expenses in consequence of it,' said Mr. Chief Justice Church, speaking for the Court of Appeals in Brink v. Insurance Co., 80 N.Y. 108."

The Eaid case is similar to the Ward case factually

l the decision therein is based on the Ward decision.

Applying the principles outlined in the foregoing

horities to the case at bar: Appellee was advised in

ober, 1964, that appellant claimed loss of subrogation rights.

letter dated July 12, 1965, reserved other grounds for

ying liability not specifically set forth in that letter.

erefore, appellee was fully on notice that other defenses

e claimed, and, specifically, that loss of subrogation rights one such defense. Accordingly, appellee is not prejudiced, its argument as to waiver must fail.

2. <u>Assertion of loss of right of subrogation</u>

Appellee's next argument (appellee's brief, pages -14) is that because appellant denied policy coverage on unds other than loss of its right to subrogation against ll, appellant cannot now rely on such loss.

In support of this proposition, appellee relies on horities to the effect that an insurer cannot <u>at the same</u> <u>e</u> both (1) deny policy coverage and (2) assert loss of rogation rights by reason of the insured's settling of a im. The purport of the authorities relied on is summarized the following annotation cited by appellee:

<u>o., "Consequences of liability insurer's refusal to assume ense of action against insured upon ground that claim upon ch action is based is not within coverage of policy," ALR2d 694, 744</u>

> "It appears to be well settled that an insurer cannot breach its contract by unjustifiably refusing to defend an action against the insured, upon the ground that the claim upon which the action was based was outside the coverage of the policy, and at the same time take advantage of a policy provision prohibiting the insured from settling any claim except at his own cost without the consent of the insurer. Consequently, an insurer's unjustified refusal to defend relieves the insured from his contract obligation not to settle, and the insured is at liberty to make a reasonable settlement or compromise without losing his right to recover on the policy."

[illegible]

[illegible]

[illegible]

[illegible]

This rule clearly does not apply to the case at bar. s, the facts herein with respect to the Beall litigation are follows:

1. Appellee filed its action against Beall on March 1, 1963 (see appellant's brief, page 5).

2. October 7, 1964, appellant learned for the first time of appellee's pending action against Beall (see appellant's brief, page 6).

3. October 12, 1964, trial commenced in appellee's action against Beall (see appellant's brief, page 6).

4. By letter dated October 23, 1964, appellant advised appellee that its action against Beall was prejudicial to appellant's right of subrogation against Beall (see appellant's brief, pages 6-7).

5. March 2, 1965, judgment was entered for appellee in its action against Beall (see appellant's brief, page 7).

6. July 12, 1965, appellant advised appellee that the Electronic and Spangler claims were not within the policy coverage (see appellant's brief, page 7).

To summarize, therefore, shortly after appellant rned of appellee's action against Beall, it advised appellee t such action was prejudicial to its right of subrogation inst Beall. It did not deny policy coverage or in any way

pudiate the policies or release appellee from its policy ligations. Appellee pursued its action against Beall to dgment.

At this point, of course, (1) appellee's litigation ainst Beall was concluded and there was nothing further for to do in the way of pursuing the wrongdoer, and (2)appellant's ght of subrogation was extinguished and with it appellee's ghts, if any, under the policies.

Thereafter, appellant did deny policy coverage, serving the right to rely on its loss of subrogation rights upra, page 3), which had been previously properly asserted.

The rationale of the authorities cited by appellee , as indicated, that when the insurer denies liability under policy, it in effect repudiates the policy. As a result, it nnot <u>at the same time</u> confirm the policy by holding the sured to the policy provisions relating to preservation of brogation rights.

The rationale does not apply in this case. Therefore, e authorities are not apposite, and appellee's argument must il.

3. <u>Cause of appellant's loss of its right of brogation against Beall</u>

Appellee next contends (appellee's brief, pages 14-29) at appellant lost its right of subrogation against Beall ause of its own conduct in failing to take timely action to tect such right.

This argument is based on a long dissertation as to ters which appellee contends are facts. In other words, ellee is attempting to show that appellant had long-standing ice with respect to the Beall litigation, and that by reason inactivity during this lengthy period, it cannot now assert loss of subrogation rights.

Insofar as the facts are relevant as a framework for determination of the question of law before this court, ellant refers the court to the statement set forth in its ning brief (pages 3-8). That statement outlines the true uence of events as supported by the record. Appellant will, ever, refer briefly to the facts relative to its notice of Beall litigation, which are as follows:

On October 7, 1964, appellant's representatives Thomas Wernette, Thomas K. Klosterman, Jr., and Charles G. Carson tended a meeting at Electronic's plant (Ex 91, page 7). At at meeting, to repeat, appellant learned <u>for the first time</u> at appellee had commenced a lawsuit against Beall, which was en on the eve of trial (Ex 91, pages 9, 11; Ex 18; Ex 90, ges 16-17).

Appellee relies on testimony of Stephen Parker that advised Wernette of appellee's action against Beall in late tember, 1964. This testimony was, however, a matter of ubstantiated memory, and the evidence establishes that such ory was faulty:

1. Wernette testified definitely that he first learned of the Beall litigation on October 7, 1964 (Ex 91, pages 9-11). His testimony is supported by a letter he wrote appellee on October 23, 1964 (Ex 18), which states in part:

> "In a conference which took place at the Electronics Specialty Co. plant on October 7, 1964, we learned for the first time that you had instituted a lawsuit against Beall Pipe & Tank Corp., who had sold certain pipe to you and which you apparently believed to be the cause of the difficulties at the Electronics Specialty Co. plant, and that in this lawsuit, which had been filed on March 1, 1963, you were asserting claims against the seller based upon claims which had been asserted against you. * * *"

2. October 17, 1964, Klosterman prepared a memorandum (Ex 16) which stated in part that "We had no knowledge of this action until three (3) days before it (the trial) commenced."

3. Carson testified that he did not learn of the Beall litigation until the October 7, 1964, meeting (Tr. 115).

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Appellee also relies on the testimony of Klosterman at s second deposition (Ex 98). In that deposition, Klosterman nentarily placed at September 21, 1964, a courthouse meeting th counsel for appellee involving a discussion of the Beall tigation. However, this testimony was obviously due to a ssing confusion. Klosterman was quite definite on his first position that he first learned of the action against Beall on tober 7, 1964, and he reconfirmed this fact upon cross-amination at his second deposition (Ex 98, page 21). Further-re, this testimony is corroborated by Klosterman's memorandum ted October 17, 1964 (Ex 16).

It is not clear to appellant what it could have done this point to protect its right of subrogation. When it arned of the Beall litigation, appellee was ready for trial the same, and appellant had no standing to proceed.

Appellee suggests (appellee's brief, page 38) that tervention would have been proper. However, under the Oregon tervention statute,

ORS 13.130

third party may intervene in an action only (1) if his right interest is of such direct and immediate character that he ll gain or lose by the direct legal operation of the judgment d (2) the issues he raises are within the scope of the original tion. See:

ne v. McDonald (1938) 158 Or 364, 75 P2d 10

This was an action by an individual who was injured an automobile accident against the insured tortfeasor. The endant's insurer filed a complaint in intervention seeking to enjoin further proceedings, (b) a determination that the icy was void as to the accident involved because of fraud by plaintiff and defendant, and (c) to perpetually restrain intiff and defendant from proceeding against it. A demurrer the complaint in intervention was sustained.

This court stated (158 Or 370-371, 75 P2d 13):

> "The generally accepted rule is that the right or interest which will authorize a third person to intervene must be of such a direct and immediate character that the intervener will either gain or lose by the direct legal operation of the judgment: * * *
>
> "It is obvious that the direct legal operation of the judgment in the case at bar would not cause intervener either to gain or lose anything.
>
> "It is equally apparent that the complaint in intervention herein tenders an entirely new and different issue from those of the complaint.
>
> "'The courts have always striven to maintain the integrity of the issues raised by the original pleadings, and to keep newly admitted parties within the scope of the original suit. * * * The injection of an independent controversy by intervention is improper.' 21 C.J. Subject: Equity, p. 343, § 341."

Tested by these standards, appellant clearly could not e intervened in appellee's action against Beall.

In summary, appellee destroyed defendant's right of
rogation against Beall, and it certainly should not be per-
ted to shift the blame for its own conduct.

4. Res judicata

In its fourth and final argument (appellee's brief, es 30-48), appellee contends that its judgment against Beall not res judicata of any claims against Beall arising out of Spangler and Electronic matters.

As indicated in appellant's opening brief, appellee ed an action against Beall on March 1, 1963, which resulted judgment on March 1, 1965, for the following (R. 204):

"1) diminution in the value of the pipe;

"2) depreciation in value of the District's water system;

"3) expense in removal of loose asphalt material from the system; and

"4) expense of repairing and replacing parts of the system."

The question presented is whether, if Electronic covers damages arising out of appellee's use of the defective e from appellee, appellee (or appellant, by right of rogation) can recover such damages in a new action against all.

A simple examination of appellee's judgment against all reveals that it has already recovered the full amount

its losses arising from the use of the defective pipe. ordingly, no further recovery may be had from Beall.

Appellee does not discuss the nature of the existing gment. Rather, it contends that it could not have recovered the Electronic claim in its prior action against Beall, and t as a result this matter is open to litigation in some ure action naming Beall as a defendant. In this connection, ellee's argument may be summarized and analyzed as follows:

1. Appellee could not have filed an amended and plemental complaint bringing a third party into the case pellee's brief, page 40). This is supposedly in refutation appellant's statement (appellant's brief, page 21) that ellee could have filed an amended complaint containing a yer for declaratory judgment as to its rights against Beall h respect to Electronic's claims. Of course, this would not e involved bringing in any third party nor would it have judiced the rights of any third party. It would merely have olved a question between appellee and Beall as to the trans-ion in suit.

In this connection, appellee ignores the fact pellant's brief, page 21) that it could have delayed trial its action against Beall pending determination of the troversy between it and Electronic.

2. Appellee could not be expected "to stir up liti-
tion against itself" (appellee's brief, pages 41-42). The
ectronic matter as an existing controversy can hardly be
aced in this category.

3. Appellee was not entitled to recover from Beall
the Electronic claim because the amount of damages had not
en established (appellee's brief, pages 42-46). Appellant has
alyzed appellee's rights against Beall in its opening brief,
d no further comment need be made here. However, assuming for
e moment that appellee were correct, again, why did it not
ek a declaration as to its rights against Beall with respect
the Electronic claim or delay trial pending a determination
the same?

4. Identity of parties is required in order to assert
s judicata (appellee's brief, pages 46-47). Of course, there
identity of parties in this case, i.e., Beall and appellee,
appellant, which would have been in privity with appellee by
ght of subrogation.

5. A cause of action does not accrue until a person
scovers that he has suffered damage (appellee's brief, page
). In support of this statement, appellee cites

Berry v. Branner (1966)
83 Or Adv Sh 757,
421 P2d 996

ich holds that a cause of action for malpractice accrues within e meaning of the statute of limitations, and the statute begins run when the patient obtains knowledge or reasonably should tain knowledge of the tort.

The authority does not support the proposition, and e proposition is irrelevant.

6. Electronic's "cause of action" was a new and stinct "cause of action" (appellee's brief, pages 47-48). ain, this is a restatement of a subject which has been fully alyzed and needs no further discussion.

To repeat, in summary, appellee's judgment against all bars further litigation against the latter and destroys pellant's right of subrogation and appellee's rights, if y, under the policies.

CONCLUSION

For the reasons set forth hereinabove and in appellant's ening brief, the judgment of the District Court should be versed and judgment should be entered for appellant.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of is brief, I have examined Rules 18, 19 and 39 of the United ates Court of Appeals for the Ninth Circuit, and that, in my inion, the foregoing brief is in full compliance with those les.

FREDRIC A. YERKE, JR.

Of Attorneys for Appellant

NO. 22193

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN L. SULLIVAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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APPELLANT'S BRIEF

I

STATEMENT OF PLEADINGS AND FACTS DISCLOSING JURISDICTION

On December 14, 1965, the Federal Grand Jury for the Southern District of California returned an indictment in four counts against the defendant for the following offenses:

Count One: For wilfully and knowingly attempting to evade and defeat tax due and owing to the United States for the calendar year 1960, by filing a false and fraudulent income tax return in violation of Title 26, United States Code, Section 7201.

Count Two: For wilfully and knowingly attempting to defeat and evade tax due and owing United States by filing a false and fraudulent income tax return for the calendar year 1961, in violation of Section 7201, Title 26, United States Code.

Count Three: For wilfully and knowingly attempting to defeat and evade tax due and owing United States by filing a false and fraudulent income tax return for the calendar year 1962, in violation of Title 26, United States Code, Section 7201.

Count Four: For wilfully and knowingly attempting to defeat and evade the income tax for the calendar year 1963, by filing a false and fraudulent income tax return for the calendar year 1963, in violation of Section 7201, Title 26, United States Code (CT 2-6). 1/

On January 3, 1967, defendant was arraigned (CT 7) and on January 16, 1967, defendant entered pleas of not guilty as to all four counts (CT 19). Trial by jury was set for June 5, 1967 (CT 22), and on June 5, 1967, the trial was continued to June 6, 1967 (CT 29).

On June 6, 1967, a jury was impanelled and sworn (CT 33), and on June 8, 1967, at 1:45, defendant moved for judgment of acquittal at the close of the government's case, which the court

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1/ CT - refers to page of Clerk's Transcript.

took under submission (CT 35). On June 13, 1967, the case was given to the jury for their deliberations at 2:15 P. M. (CT 55).

On June 13, 1967, at 4:50 P. M., court reconvened, the court admonished the jury and separated them with orders to return directly to the Jury Room at 9:30 A. M. on June 14, 1967, for further deliberations, and court adjourned (869). 2/

On June 14, 1967, at 11:37 A. M., the court gave further instructions to the jury (872-878). At 2:45 P. M. on said date, the court gave further instructions (879-883), which included the "Allen" instruction. At 4:25 P. M. the verdict was returned by the jury with the defendant being found not guilty on Counts One and Two and guilty as to Counts Three and Four, and the court denied defendant's motions for acquittal taken theretofore under submission (CT 56).

On July 24, 1967, post-trial motions were argued, submitted and denied (RT 4-28). 3/ On July 28, 1967, the defendant was sentenced to two years in custody on Counts Three and Four, to run concurrently, on the condition that the defendant be confined for a period of thirty days with the execution of the remainder of the sentence of imprisonment suspended, and defendant placed on two years probation. On July 28, 1967, a timely notice of appeal was filed by the defendant (CT 81).

Jurisdiction of the District Court is based on Title 26,

2/ (---) - refers to page of Reporter's Transcript.

3/ (RT) - refers to Reporter's Transcript of July 24 and 28, 1967.

United States Code, Section 7201, and on Title 18, United States Code, Section 3231.

Jurisdiction of this Court is based on Title 28, United States Code, Sections 1291 and 1294(1).

II

STATUTES INVOLVED

Title 26, United States Code, Section 7201 reads as follows:

> "Any person who wilfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$10,000.00 or imprisonment of not more than five years, or both, together with costs of prosecution."

III

QUESTIONS PRESENTED

1. Did the Court err in failing to rule on defendant's motion for acquittal made at the conclusion of the government's case under Rule 29a?

2. Did the Court err in allowing the jury to separate after it began to deliberate?

3. Did the Court err in failing to give the complete

"Allen Instruction" so as to prejudice defendant?

4. Is the verdict contrary to the weight of the evidence?

IV

STATEMENT OF THE FACTS

(Government's Case)

On June 6, 1967, there was filed in the trial a stipulation concerning government's Exhibits 1, 2, 3 and 4, the income tax returns of defendant for the years 1960, 1961, 1962 and 1963 (CT 30, 31 and 32).

Witness JOHN M. HORNER was called and testified for the Government that he prepared Exhibits 1 through 4 (132); that the information contained on the returns were wholly received from the defendant (135).

FREDERICK WERDER testified that he operates the GOURMET RESTAURANT; identified the business records of the corporation relating to salary checks of the defendant (141); testified relating to a bonus arrangement with the defendant (141); identified salary advances made to the defendant (144), and expense checks (145); that defendant is the executive chef (146); stated that many thousands of dollars in salary advances were made to the defendant in the period 1960 through 1963; that the advances for 1960 through 1963 were repaid subsequently (149), explained the duties of an executive chef (150) and that defendant was responsible for purchasing of supplies namely, meat, vegetables, but no equipment (151);

that within reason the defendant had discretion as to what supplier was to be used (152); that defendant was required to purchase from certain suppliers up to a proportion of approximately 25 per cent (153); that defendant was not required to purchase from PHILLIPS POULTRY (153). He desired that defendant purchase some meats from MORRIS RATNER (154); defendant was not required to purchase from SOUTHERN CALIFORNIA TRADING or DOUGLAS BROS.; defendant was required to purchase from ROYAL PRIME STEER (155); that in checking prices, WERDER found that the defendant's purchasing policies were fair and that the pricing from the purveyors was in line with the prevailing prices and the same were constantly checked through WERDER's auditing department (157); that he received no complaints from COAST POULTRY, DOUGLAS BROS. or PHILLIPS POULTRY that defendant demanded from them for money in exchange for orders from them (158); that Defendant is the president of the Chef's Association (158); that the defendant went to conventions at his direction (159); that accumulated checks of defendant of up to $3500.00 were held by WERDER (161); that MORRIS RATNER is a shareholder of C.A.W. Corporation (161); that there were other parties who do purchasing for the GOURMET RESTAURANT other than the defendant (161).

On redirect examination, WERDER testified that he received no complaints from suppliers that defendant was requesting money (162-3), but that a supplier told him that defendant had borrowed some money and repaid it back (163).

HARRY PHILLIPS of PHILLIPS POULTRY COMPANY

testified for the government (166), that he knew the defendant since 1955; that his relationship with the defendant was business (168); that the defendant placed orders with him on the telephone for poultry or eggs; that he gave sums of money to the defendant (168) beginning about 1957, when the defendant asked for a loan due to an accident that he had (168-9); that he advanced money to defendant; that there were no notes or any documents signed; no agreement for repayment and no interest was discussed; that he has not been paid back the sum of either $300.00 or $400.00 (169); identified the business records of PHILLIPS POULTRY; that the business records reflect a $400.00 bad debt to the defendant (173); that defendant made some payments on the loan from time to time (174); that he could not identify the entries made on the books (174-5); that he wired $200.00 plus the telegraph charges to the defendant in Las Vegas (177); that he directed that the $203.52 check involving the funds sent to the defendant in Las Vegas, be charged off as bad debt (180); identified a check dated September 2, 1959, in the sum of $300.00 of which he had no recollection (180-181), the endorsement on the check payable to the defendant was made by PHILLIPS (182); that the check for $300.00 was reimbursement for a payment made to the defendant (182); that his recollection is that he told the bookkeeper to charge the $300.00 check off to bad debts (185); that on August 18, 1961, a check for $300.00 payable to PHILLIPS was for a loan he made to JACK SULLIVAN on July 31, 1961 (185); that at the time Exhibits 22 through 24, were made, the witness thought they were loans (186); that he collected

$50.00 or $100.00 from the defendant (186); that he gave the defendant sums of money other than Exhibits 22, 23 and 24, of a different nature (187), Exhibit 17 is the witnesses' personal checks (189); that the explanation for giving the personal checks to defendants was: "I didn't want to be involved with the business any further. I thought I could well afford it; that I would give him these checks and not go through the business books anymore through the business. I was not sole owner of the business and I didn't want to get involved. My employees were profit sharing. I decided that I would handle this thing differently and do it on my own." (190); that the purpose of the money given to the defendant was for loans (190); that there were no notes given; no due dates when the loans were to be repaid (190); no interest on any of the loans (191); that he might also have given defendant some cash in 1960 (191).

In response to questions regarding whether any type of percentage of his business with GOURMET RESTAURANT were paid to the defendant, testified, "Well, it would be based on what I felt the business might be worth, knowing that there were some small loans out and that he had paid back a couple of small payments from time to time, I would base it on just how well we got along (192); that there was no particular percentage criteria discussed." (192). That in the years 1961, 1962 and 1963, in addition to the checks given to the defendant, he gave defendant cash (194). There was no set period as to how often defendant was given money (194); that he does not remember whether any payments to the defendant were made by check or by cash (194); that in the years 1962 and

1963 gave several small payments to the defendant, possibly once a month or every couple of months (194); that checks from his personal account had no connection with PHILLIPS POULTRY and were personal payments for loans (195); that he gave the defendant money in the hopes that he would continue to get the business of the defendant and in hopes that he would get some of it back from time to time (196); that he received no money back from the defendant on any of the checks, Exhibits 23 through 25 (197); that he mailed Exhibits 17 through 20 to the defendant (198); that defendant did not ask for the amounts shown on the checks in Exhibits 17 through 20, but that PHILLIPS would decide the amount; that several times defendant might have asked for some certain amount of money for a loan he had to pay or for a bank payment or for whatever it might be, but that the decision as to the amount of money he was going to give was decided by the witness PHILLIPS (198); that the GOURMET RESTAURANT is a valuable account to the witness (199) [Court then adjourned for the day (200)].

On June 7, 1967, pursuant to permission to reopen, PHILLIPS was recalled by the prosecution, as follows (204): "I would like to ask you if you would care to change your testimony in regard to the nature of those payments to the defendant." (205). Defendant objected to the foundation for changing of testimony as follows: "I am going to object to this with respect to changing the testimony. I think that unless you can show a foundation for material change, the circumstances from the time the witness was on the stand yesterday afternoon until this morning, that I would object to

the procedure." The Court overruled the objection, stating, "I think we want to know what the facts are. Of course, you can comment on it and you may interrogate him on cross-examination . . . if his testimony yesterday was in error, we ought to find out what the truth is." (205).

"Q. Mr. Phillips, yesterday, in regard to Exhibits 17 through 20 you testified that those payments were loans. You wish to change that testimony?

"A. They were given in appreciation for routine of the business. They were not considered too much of a loan." (206).

"Q. In consideration of what business?

"A. The business we were doing with the restaurant.

"Q. Was the defendant doing the buying from you for the Gourmet?

"A. Yes, ma"m, he was.

"Q. So the checks, Exhibits 18 through 20, are in appreciation to the defendant.

"A. Yes.

"Q. They are not loans?

"A. Well, no." (207).

In cross-examination, PHILLIPS testified that nothing happened between the time of his leaving the stand in the afternoon of June 6, and the morning of June 7 (207). That afternoon he

talked to the defendant; talked to MRS. DUNNE (the prosecutor); that he talked with FOLEY and CALKINS, but not in relation to business; that he was in MRS. DUNNE's office after leaving the stand on June 6 (208), was there for five minutes (209); that the Government officials and representatives did not offer any reward or immunity or anything in way of any value or consideration in exchange for his changing of his testimony; that nothing was said except, "to tell the truth" in MRS. DUNNE's office (209); that he told the truth both on June 6 and on June 7 (210); that defendant asked him for a loan of money and that he loaned the defendant money; expected to get paid back; that he did not give the small payments back to defendant (210-211); that the first transaction between the defendant and the witness was asked for by the defendant (211); that he expected to get paid back for that (212); did not intend to give it to him as a gift; and after the third or fourth check given to the defendant, the witness gave no further thought of whether he was going to get the money back (212); that he gave the defendant between three and five thousand dollars (213); that he received about $150.00 to $250.00 back from the defendant (213); that he received $100.00 on account at Churchill Downs (214); that "after the case was involved here, the defendant wanted to give him back some money", and he refused the payment since the case was under investigation (215); that the money wired to the defendant in Las Vegas was to be considered a Christmas gift (215); that the defendant never mentioned the condition of doing business for the sums of money (216); that on Exhibit 23, a check for $300.00 (217) there

is an endorsement of JACK SULLIVAN and HARRY PHILLIPS (218); that defendant did not place his endorsement thereon, but that the witness did; that defendant did not authorize him to place his name on said check as an endorsement, but that defendant had the money prior to the issuance to that check (218); that the computation of the amounts sent to the defendant in Exhibits 17 through 20 were by his own judgment; that there was no definite percentage which he paid over (219); that he gets between 2-1/2 to 3 percent net profit in a good year (225); that the defendant still owes him money (227); and he doesn't know how much the defendant still owes (227).

PHILLIPS testified on re-direct examination, "Those personal checks in appreciation of our business, they are still open." (227). Further, "But I don't think that they are loans anymore, I think they are appreciation for the business we were doing with that company." (228).

On re-cross examination, PHILLIPS explained, " 'appreciation of business" as "We did not have to pay alot of salesmen or never have paid any commissions. These were given in appreciation because we had no salesmen," and "were not asked for by the defendant, but got to be routine." (228).

SHERWIN J. GERBER testified on behalf of the government that he is a Certified Public Accountant for COAST POULTRY for the years 1957 through 1964 (230); identified certain books and records of COAST POULTRY, Exhibits 29, 30 and 31 in evidence (232); that Exhibits 26 and 27, COAST POULTRY COMPANY's checks are not posted to the notes and loans receivable accounts

in Exhibit 30 (239); that Exhibit 27 contains four items, two of which are charged to purchases and two of which are charged to commissions and are so reflected in the books and are not posted to loans receivable account in Exhibit 30 (240); that GERBER had no recollection of any discussion of items in Exhibit 27 with the deceased GEORGE CINQUINI, owner of COAST POULTRY COMPANY (241); that the notes receivable ledger indicates on April 12, 1960, a loan being made to JACK SULLIVAN in the sum of $1500.00, on October 20, 1960, shows a loan being made to SULLIVAN in the sum of $1,000.00; March 27, 1961, a loan of $500.00 to SULLIVAN; August 14, 1961, a loan of $400.00 was to the defendant (242-243); May, 1962, a loan to SULLIVAN in the sum of $500.00. Referring to defendant's Exhibit B, shows a $200.00 check paid to COAST POULTRY (244) and deposited in the California Bank, account of COAST POULTRY, in January of 1964, and that COAST POULTRY had an account at the California Bank at said time (244); that the credit of $200.00 appears on the loan receivable ledger as a credit (244); that there are no general journal entries relating to the defendant in 1963 (247); that he had no knowledge of any financial transaction involving COAST POULTRY that was not recorded on the books (248).

MYRON CURZON, an attorney for GEORGE CINQUINI, owner of COAST POULTRY (250), was called by and testified for the Government that he took custody of the books and records of GEORGE CINQUINI and COAST POULTRY when MR. CINQUINI became terminally ill (250-251). Referring to Exhibit 31, he

stated that he had questioned the defendant regarding the said notes and defendant acknowledged that the notes were due, but that he had paid to CINQUINI the sum of $500.00 in cash (253); that he and the defendant made arrangements for installment payments on the notes (254); that he received payments over a period of years (255); that defendant made no statements whether any other monies were owed to COAST POULTRY (255), and at the time of trial, the estate of GEORGE CINQUINI has been paid the total face amount of all of the notes, Exhibit 31, without interest (257); that he did not give the defendant credit against the face amount of the notes for the $200.00 check dated January 19, 1964, defendants B and C (258).

SHERWIN GERBER was recalled and testified that the notes, Exhibit 31, total sum of $3900.00 and reflected in the notes and loan receivable accounts are not Exhibits 26 and 27. On recross testified that the $200.00 credit of January 19, 1964, was applied to the notes and that the balance after such application was $3,700.00 (261).

BEATRICE EBELING was called on behalf of the Government and testified that she is a bookkeeper employed by RATNER BROS. MEAT COMPANY and Secretary of the corporation (263); identified Exhibit 27, are two checks for $100.00 and $150.00 posted in Exhibit 38 which is the disbursements records and summarized in Exhibit 34 and that they are charged to Account 510 (266), which account is labeled Food, Consultant and Fee Account (267).

Defendant objected to the testimony on grounds of

immateriality and irrelevancy as to the particular account to which RATNER BROS. MEAT COMPANY charged the subject check and that the same were not binding on the defendant, to which the Court generally agreed (268-9). However, the Court ruled that the evidence may have some value in throwing light upon the entire transaction and maybe some evidence as to his intention (269), and the objection was overruled. The Court then instructed the jury that whatever election MR. RATNER may have made as to how to charge the checks were not binding on the defendant, but was allowing the evidence in to show light on the entire transaction and upon the intent of the defendant in receiving them (272). MRS. EBELING further testified that the payments then go to the chef, who was the named payee in the account, and in this particular case, went to the defendant (273).

ROBERT W. JOYCE was produced as a witness and testified on behalf of the Government that he was president of SOUTHERN CALIFORNIA TRADING, which was engaged in importing and exporting and brokering of seafood products (276-7). Witness identified Exhibit 55, a check dated March 5, 1963, for $225.00 drawn on SOUTHERN CALIFORNIA TRADING COMPANY, payable to defendant (280); that the $225.00 was given to the defendant as a commission (281); identified a memorandum, Exhibit 52, and that it was prepared and bore the reason why the check was issued to the defendant, that there was no agreement, nor did he get any money back for that check (282); that SOUTHERN CALIFORNIA TRADING did loan the defendant $1000.00 on August 27, 1963, and

a loan was made and a note was received (286); identified a check disbursement record, Exhibit 70 of SOUTHERN CALIFORNIA TRADING; that the account charged was notes receivable, which is crossed out in pencil to an account called "Sales Disct." that SOUTHERN CALIFORNIA TRADING did not have an account called "Sales Disct." (295); that Government's Exhibit 70, the original entry is in carbon (296), the strike-over in the word Sales "Disct." is in pencil;at the time he left SOUTHERN CALIFORNIA TRADING in November, 1963, there was no account called "Sales Disct." (297); that when the money was loaned to SULLIVAN, the note ended up in the files of the corporation (297); that he knew of no demand from SULLIVAN for the $225.00 for services (298); that the initiation for the writing of the check was from MR. JOHNSON (298).

MORRIS RATNER called as a witness by the Court, testified that he is the owner of RATNER BROS., meat and provision company of Santa Monica (305); engaged in the business of wholesale meat and sold to the Gourmet Restaurant in the years of 1960 through 1963 (305); that his relationship with the defendant has been social (307), and not primarily business; identified Exhibits 38 through 44 (309); testified that Exhibit 32 the two checks totaling $250.00, were for tickets to a chef's convention in Anaheim, and he issued those checks for the purchase of tickets from the defendant (311).

With respect to Exhibits 38 through 44, involving 52 checks, totaling over $12,000.00, that he gave them to the defendant for loans made to JACK SULLIVAN (312) and that for each check given he was asked for loans (313); that he lent the money to him at various

places after being asked for it by the defendant (315); that there was no interest demanded by him of the defendant on the loans, nor did the parties discuss interest; that the defendant still owes him approximately $500.00 to $700.00; that he did not keep a record of how much the defendant owed him at any certain time (318). Payments were made by the defendant in cash to RATNER at sporadic intervals; that it could have happened that he had several loans outstanding before he received the payment on even one (321); that at any given time he did not know exactly how much defendant owed him (321); that he knew he was paid back but he can't swear to when he was paid back (323).

KATHRYN MOWAT identified Exhibits 49, 50, 51, 52, 53, 55 and 56, as business records of DOUGLAS BROS. for the years 1960, 1961, 1962 and 1963 (325).

ALBERT R. HAZEN was produced and testified for the government that he is a public accountant and audited the books and records and prepared the tax returns of DOUGLAS BROS. PRODUCE (327); and has done so for thirteen years. He audits the books every month; identified a write-off to bad debts to $1400.00 owed by the defendant to bad debts. As a result of owners' instructions, charged off loans to bad debts (330); that he charged off $3200.00 pursuant to instructions, crediting advances and loans and charging commissions, said $3200.00 being owed by the defendant (332); that the commission accounts as used by the DOUGLAS BROS. was for commissions paid to individuals for obtaining business for them (332).

The defendant moved to strike all of the testimony of witness HAZEN on the grounds of immateriality, since all of the testimony related to occurrences happening prior to the indictment. The Government explained that a pattern of a loan, later being charged to commissions, was shown and the evidence will show that the checks charged to sales promotion show a pattern of first starting as a loan and then a change, and the Court ruled that the motion to strike was denied (339-340).

HAROLD HOLMAN called on behalf of the Government and testified that he is an office manager, account manager and bookkeeper (343); that he did not work full time in keeping the books of ROYAL PRIME STEET (344). HOLMAN worked as bookkeeper full time for ALL AMERICAN. ROYAL PRIME STEER was a subsidiary of ALL AMERICAN. HOLMAN testified that he was acquainted with DEAN FLANAGAN; that he gave FLANAGAN periodically sums of cash (360); that the sums of cash had no relationship with purchases by the GOURMET RESTAURANT (360); that he gave these sums of cash to FLANAGAN weekly and sometimes two weeks at a time (360); that when FLANAGAN came to the office, he picked up the sales to the Gourmet Restaurant and gave him three percent of the sales in round figures in cash (361). It went on at least three years starting about the end of 1959.

In cross-examination, testified FLANAGAN was the general manager in 1959 at PRIME STEER. He was on a salary and a bonus arrangement, which was based on the profits of the company; that the plan of three percent of sales to GOURMET RESTAURANT

to be paid to FLANAGAN was set up by BLAINE HUTCHINSON; that there was no particular reason why the sums were paid in cash to FLANAGAN, but he was never paid by check nor any reason why he was not paid by check and the sums of each particular payment were for around $150.00 and $200.00 (366); that FLANAGAN received a bonus over the year's sales and in a lump sum and was paid by check (367).

DEAN AUTHUR FLANAGAN called on behalf of the Government and testified that he was employed by ROYAL PRIME STEER as a salesman, sales manager and general manager (368-9) and became general manager in 1962; became president of the corporation in 1962; that he now has a majority interest in ROYAL PRIME STEET (370); that he now has in his custody and control books and records of ROYAL PRIME STEER (371). Exhibit 57 were the sales records to GOURMET RESTAURANT; that he became acquainted with the defendant around 1958 or 1959 (373); that his association was business (373); that he had the following conversation with the defendant:

> "A. That in lieu of the restaurant and the prestige that we had there, the press and necessity of the sales person to call on the account would not be required that this could be used as an advertising allowance to be passed on to the gentlemen.
>
> "Q. Well, who said this, 'in lieu of salesmen' and all of this about advertising?
>
> "A. Mr. Sullivan.

"Q. He made those statements to you?

"A. (Witness nods.)

"Q. Was there any statements made in regard to what was the salesmen's commission that he is talking about or the salesmen's or middleman?

"A. Yes, it was three per cent.

"Q. Was that actually discussed?

"A. Yes.

"Q. Now what, if anything, did you tell him?

"A. That I would take it up with the people at my corporation and give him an answer.

"Q. Did you in fact take it up with the people of your Corporation?

"A. Yes, I did.

"Q. Is this Mr. Baine Hutchinson? (375)

"A. Yes.

"Q. Mr. Hutchinson?

"A. Yes, ma'm.

"Q. Did you in fact subsequently give the defendant an answer?

"A. Yes. After being told that the restaurant warranted it from the advertising basis because of the size of it and this sort of thing, that it would be all right. I told him yes, it could, it would be." (376).

There were payments made to the defendant beginning the

end of 1959 (377); made on close to a monthly basis, in cash and that he made the payments directly to SULLIVAN (377) at the restaurant, in the lot or some place in the restaurant or around the restaurant; that he received the money to pay over to SULLIVAN from the general office of ALL AMERICAN (378); got the cash from MR. HOLMAN (378). Sales were tallied up and computed for the previous period to the GOURMET RESTAURANT, took a three percent figure and paid this over to SULLIVAN (378), and made the payments approximately once a month starting the end of 1959 until 1963 (378-9). In 1963 FLANAGAN made the payments by himself by declaring himself a bonus; paid approximately $2100.00 to SULLIVAN in 1963 (380); paid the $2100.00 over a twelve months period in cash (381). Payments were made in the parking lot at Disneyland; that the payments were first made directly by the witness who then declared himself a bonus and reimbursed himself (381). The payments in 1963 were not loans (382). The payments given to the defendant were:

"For the same thing, for advertising allowance or extension of the advertising allowances as they were previous to this time."

Stopped paying in 1964 (382). The witness handled the Disneyland Gourmet account by himself all along (385); that he did not know the defendant until he solicited the account (385); that FLANAGAN personally did not loan the defendant any money between 1956 and 1959; that between 1956 and 1959 PRIME STEER loaned SULLIVAN money (389); that he does not know whether PRIME STEER was ever repaid (390). Between 1959 through 1963 he has no

recollection whether PRIME STEER loaned defendant any money (399); that between 1958 through 1963, he personally did not loan SULLIVAN any money (390); that he gave $2100.00 to defendant in the twelve months period in 1963 (394). Exhibit 60 represents reimbursement to himself for the $2100.00 (394); that the payments terminated because he did not like the practice and didn't want to do it anymore (403).

DANIEL FOLEY of the Internal Revenue Service was called as a witness and testified for the Government (420); that MYRON CURZON turned over records of COAST POULTRY pursuant to subpoena to the Government, but that Mr. Curzon did not turn over any records concerning cash disbursements or receipts for 1962 or check stubs or entries on check stubs for 1962 and 1963 (420); that he prepared Exhibit 28 (421) from information from the cancelled checks and available check stubs of COAST POULTRY on or about July 7, 1964 (421); that Exhibit 28 is a resume from the check stubs of COAST POULTRY (422).

On cross-examination FOLEY testified as to other information on the check stubs other than that which was in his recap Exhibit 28 (434-435), and on eight of the checks where the payee was shown to be the defendant, on the stub themselves, notation show charges to be to drawing, travel and entertainment (436); that the drawing account was the proprietorship account of GEORGE CINQUINI, owner of COAST POULTRY (436) and the other expense accounts such as travel and entertainment are appropriate charges to business (437); that there are charges to the purchases account for checks

payable to the defendant; and there are charges to commissions without endorsements on the checks with a notation "C A W" believed to be the parent corporation of GOURMET RESTAURANT (440) and charges to the commission account in the sum of $311.00 for which there is no endorsement and charged to commissions C A W with a notation "Beverly W." (440); that the checks for $311.00 and $159.00 charged to commissions are not endorsed by C A W or defendant, and the checks are payable to cash (442).

FORREST B. CALKINS was produced as a witness and testified on behalf of the Government; and it was stipulated that the witness was qualified to testify as an expert technical advisor and accountant (445); that he prepared Exhibit 72, consisting of four pages (446) and prepared computations thereon (446). The computations was based on the testimony of the witnesses and exhibits offered (447); that for the year 1960 computed $7,111.94 (450) as follows: PHILLIPS POULTRY COMPANY $575.00; RATNER BROS. MEAT COMPANY $2,650.00; DOUGLAS BROS. $2,700.00; ROYAL PRIME STEER $1,186.94 and a net adjustment $7,107.90 (452); that the tax liability for the year 1962 as corrected is computed by the witness shows a tax liability of $2,707.22 (452). For the year 1961 shows additional income of $7,630.78 from PHILLIPS POULTRY COMPANY $500.00; RATNER BROS. MEAT $1900.00; DOUGLAS BROS. $3800.00; PRIME STEER $1430.78 and a net increase in taxable income of $7310.56 and a computed tax liability of an additional $2883.05 (456). As for the year 1962, additional income of $8,050.11 (457); PHILLIPS POULTRY $150.00; COAST POULTRY

$978.00; RATNER BROS. $2200.00; DOUGLAS BROS. $2675.00 and from ROYAL PRIME STEER $2047.11, and the computed additional tax was $3,082.38 (458). As for the year 1963, additional purported income of $6,398.14 (460) as follows: PHILLIPS POULTRY $556.00; COAST POULTRY $549.50; RATNER BROS. $2500.00; SOUTHERN CALIFORNIA TRADING $225.00; DOUGLAS BROS. $200.00; ROYAL PRIME STEER $2367.64, total of $6,398.14 showing an additional tax liability of $2415.53 (461).

On cross-examination MR. CALKINS testified that the testimony of Mr. Ratner was that all of the money paid over to the defendant were loans (471).

(Defendant's Case)

NICK DOUGLAS was called by the defendant, and after identifying himself, as in the business of the wholesale produce business, as DOUGLAS BROS. PRODUCE COMPANY (499-500); refused, thereafter, to answer further questions respecting any financial accommodations given to the defendant on grounds of self-incrimination.

ALBERT WOLLMAN identified himself as Manager of DAIRY FRESH PRODUCTS (510), involved in the sale of dairy products and knows the defendant (511). He testified that the Gourmet Restaurant purchased items from his company (511). Thereafter, the Government objected to questions regarding the following testimony:

(1) That he loaned money to the defendant; had been paid back; has never been asked for commission or a kick-back; that this evidence was offered to show that the pattern alleged by the Government was refuted by this testimony (512), and was also in the nature of impeaching testimony relating to payments of 3 percent of business (513-517), and the Court ruled that the testimony was incompetent (517).

LOUIS JOHNSON testified that he worked for SOUTHERN CALIFORNIA TRADING CO. in 1963 (520). That in regard to the $225.00 paid by SOUTHERN CALIFORNIA TRADING CO., testified that he gave it to the defendant with no strings attached and was not asked for the money (526).

JACK WILANTT called by the defendant and testified he was in the wholesale meat business for approximately 30 years at OMAHA MEAT COMPANY (533), as General Manager (534); that in the meat business of OMAHA MEAT COMPANY, they have a net profit of approximately 1 to 1-1/2 percent (537); that he had never heard of any purveyors paying 3 percent of sales as a sales inducement or as a kick-back commission and that OMAHA MEAT COMPANY does not pay chefs 3 percent as commissions to salesmen plus car and minor expenses (547), which is used as a measurement so that 3 percent of sales as against $125.00 minimum guarantee.

The defendant, JOHN L. SULLIVAN, was called and testified relating to business he did with PHILLIPS POULTRY (550); that he paid Phillips back for monies owed (552); denied ever asking Phillips for 3 percent of the sales to Gourmet Restaurant in order

to do business (555); that Phillips excused the payment of the money wired to him in Las Vegas to be treated as a Christmas present (556); that the endorsement on Exhibit 23, a check for $300.00, dated September 2, 1959, was not his signature; that he did not recall getting said money (557). Exhibit 24, a check payable to HARRY PHILLIPS POULTRY CO. remained the same, and even on the morning of his testimony, he is still ordering from Phillips (558). That with respect to all of the financial transactions he has had with Phillips, other than the money wired to Las Vegas, Phillips never stated that he was not looking for reimbursement and never pressed him for payments, and when the defendant repaid Phillips money, Phillips never refused to take it (560); that he still owes Phillips $900.00 (561). He explained about the loans made with COAST POULTRY, accumulations of monies advanced from time to time (564); that after Mr. Cinquini's death, he arranged with Mr. Curzon to pay COAST POULTRY back at the rate of $200.00 per month (567), and repaid a total of approximately $3900.00; that Cinquini had a system of charging him interest in advance (570); that he never asked COAST POULTRY for a percentage of sales to do business with him (572); that he received nothing other than a Christmas present of $100.00 for doing business with Cinquini (572), which was received in cash (573).

Did not remember the $225.00 check received from SOUTHERN CALIFORNIA TRADING COMPANY and acknowledged that the subject check, Exhibit 45, bears his signature (573).

That he knows all of the DOUGLAS BROS. (579), and has

known them for approximately 14 years, and purchased produce from them (580); that he received financial help from them, which were mostly repaid by cash (581); was never an employee of DOUGLAS BROS.; that he received no commissions from DOUGLAS BROS. for performing any services nor was the subject discussed (582-583); identified the endorsement of NICK DOUGLAS on a check, defendant's Exhibit F, in repayment (583); that he does not owe DOUGLAS BROS. any further money (584), the final payment having been made in May, 1966, by check (585); that he continues to do business with DOUGLAS BROS., and will continue to do so (585).

That he knew MORRIS RATNER; had private financial transactions with MORRIS RATNER (587); that Ratner would loan him money by giving him personal checks (587-588); that initially, he was supposed to repay a previous loan before he could get a second loan from RATNER (588); that on one occasion, he borrowed $1000.00 from the Bank of America, co-signed by MORRIS RATNER and gave the proceeds to RATNER in payment of loans made from RATNER (588-9); that he repaid RATNER at various places (591), and his current standing with RATNER was that RATNER contended that he owed $400.00 (592); that the reason for the repayment in cash is that in the beginning he was repaid by checks, which on several occasions had bounced (596).

That he knows DEAN AUTHUR FLANAGAN (597); that his initial contact was after FLANAGAN had been doing business with GOURMET (597); that he was required to buy meats from ROYAL PRIME STEER (599); that in 1958 or 1959, he borrowed $500.00

from ROYAL PRIME STEER through FLANAGAN (602), and identified a check given to ROYAL PRIME STEER in repayment, which bore ROYAL PRIME STEER's endorsement (603); that he had financial transactions with FLANAGAN (605), in the sum of $200.00 or $300.00, which he would pay back in two or three weeks and that the years 1960 to 1963, he borrowed approximately $800.00 to $1000.00 per year, and paid back the previous loans before he borrowed the next one, and he always paid in cash since this was required by FLANAGAN (605). That there was never an arrangement between he and FLANAGAN whereby FLANAGAN was to pay 3 percent of sales to GOURMET to the defendant (611); that FLANAGAN did not pay 3 percent of sales made to GOURMET RESTAURANT to the defendant in any month (612); that he never solicited a commission as a condition of doing business of 3 percent of sales to GOURMET RESTAURANT from FLANAGAN (612).

That PHILLIPS never sent him a Form W2 or a Form 1099 (612-613). SOUTHERN CALIFORNIA TRADING never sent either of those forms (613), nor did RATNER, DOUGLAS BROS. OR FLANAGAN (613-614); that as of June 9, 1967, he does not owe FLANAGAN any money; that he continued to do business with FLANAGAN in 1965 (617), and the GOURMET RESTAURANT stopped doing business with FLANAGAN around Christmas of 1965 (681); that the defendant filed Bankruptcy, Exhibit 41, since a Mrs. Provatas got a judgment against him for an accident in the sum of $5717.67; she is listed as a creditor along with other creditors on the bankruptcy petition (624); that his driver's license was

suspended as a result of that accident (626); that he borrowed a car from DOUGLAS BROS. for over a year; that all of his creditors were repaid even though he filed bankruptcy, other than Mrs. Provatas (627-628).

On cross-examination, admitted taking depreciation for the year 1962, 1963 and 1964, on the car owned by CHRIS DOUGLAS (635-638); that the defendant knows that it is unlawful to give kick-backs or rebates for person selling meat or poultry (639); confirmed that he began borrowing from FLANAGAN in 1959 (643), off and on through 1963; that he could not tell how much he borrowed since this was irregular, paid all of those borrowing back; had to repay the first loan before he could get the second loan; denied borrowing a total of $1300.00 from ROYAL PRIME STEER (646); he had two bank accounts in 1960 through 1963, one at the Bank of America and one at the Security First National Bank in Anaheim (648), but he did not have them both at the same time (648). He does not have any recollection of the check in the sum of $225.00 from SOUTHERN CALIFORNIA TRADING (648), which check is marked "cashed" at the Bank of America (649). Beginning in 1960, he owed a total of $5,000.00 to COAST POULTRY (652); that Cinquini or Coast Poultry always charged interest from 8 to 10 percent (653); that approximately a year prior to June of 1964, Cinquini brought him six notes, dated on separate dates, which he executed on the same day (655); that he began repaying on the $5000.00 sum about six months before Cinquini died (657). Paid one check of $200.00, the rest was in cash, and a Promissory Note was returned to him which he tore up (657).

Five notes, defendant's Exhibits C to H, were part of the six notes originally signed (658-659). He signed them even though some detailed information contained on them were incorrect (651). He borrowed $1000.00 from SOUTHERN CALIFORNIA TRADING; that he did not pay interest thereon nor was it discussed (653); that the interest rate of 6-1/2 percent and the one year due date was not correct on the SOUTHERN CALIFORNIA TRADING note wherein he agreed to and did repay it in four months (664). He was borrowing from the DOUGLAS BROS. from 1956 on (676); that he would borrow $500.00 and then would not borrow again for about four months, but in the interim, he paid the $500.00 previously borrowed, payments were spasmodic depending on whether he had the money (676). That after several bad check experiences, the DOUGLAS BROS. requested that he pay in cash (678), which was before DOUGLAS BROS. were audited by the Government (679). He completely repaid DOUGLAS BROS. in 1966 (683); related the transactions had with loans made from RATNER (683); that he received them on or about the date they bore and normally repaid the first check before receiving the next check (687) and repaid by cash (688), since he had bounced some checks on RATNER (685).

With respect to PHILLIPS, he rarely borrowed money from 1957 to 1960, but whatever he borrowed, he repaid (690); that he owed PHILLIPS $900.00 at the time he was being investigated when PHILLIPS told him, "I can't lend you anymore money because I understand you are being investigated and they have been over to talk to me." "I can't loan you anymore money and you better repay what

you owe me." That his payments to PHILLIPS were also cash, but that PHILLIPS did not request that he pay in cash (693); that from the purveyors in question, namely, PHILLIPS, FLANAGAN, RATNER, JOYCE, COAST POULTRY and DOUGLAS BROS., that payments received were from 1960 through 1963, were received in person except that HARRY PHILLIPS mailed checks to him because he had glaucoma and couldn't drive; that he had no agreements with any of the suppliers as to how frequently he was to receive money (693); that he made purchases from all the suppliers in the years 1960 to 1963; that he kept no records of any type regarding the sums of money he was receiving and did not even keep records at the bank (694); that he may have made notations on a calling card as to what he owed people (694). That he always knew what he owed the six suppliers (695); that he never received sums of money at the time he placed orders with the suppliers (695). Denied receiving a percentage from ROYAL PRIME STEER or DEAN FLANAGAN in the years 1960 through 1963 (722). Denied receiving 30 cents for a case of eggs and 3 percent of the remainder of business done with PHILLIPS POULTRY with GOURMET RESTAURANT. Had no percentage arrangements with any of these people for money relating to the gross of the business being given them (723) or with COAST POULTRY. That he did not receive from COAST POULTRY 5 percent of the month's gross business for orders given to GOURMET RESTAURANT (726).

On redirect examination, identified defendant's Exhibit O as proceeds turned over to FLANAGAN in repayment of a loan made

to him when the said exhibit has a notation "DF" (728); explained why he took the car depreciation (731) in that he did not know that he could not take depreciation unless he owned the car (732). After looking at Exhibit 76, which affects COAST POULTRY, stated that he could not truthfully identify whether the endorsements thereon were his although they looked like his own, but there are almost misspellings of his name (737). That he hired an attorney named JOSEPH FAIRFELD to handle his bankruptcy matter (740); that said attorney did not go down each item on the schedule as he was preparing the schedule (740); that defendant does not know whether all the information he gave to the attorney was reported on the schedule (741); that he did not read question No. 9 before he gave Mr. Fairfeld his answer nor was he ever asked the substance of question No. 9 (741); explained that he signed seven sets in a hurry and was advised to sign in a hurry (742).

VELMER EUGENE HOOPER was called as a witness (251). His occupation is a meat man, he knows DEAN FLANAGAN's reputation in business circles for truth, honesty and veracity, and the reputation for truth, honesty and veracity of FLANAGAN is bad (753).

JOE ALLEN BARNES was called to testify on behalf of the defendant (755). He is a chef at the IRVINE COAST COUNTRY CLUB, knows DEAN ARTHUR FLANAGAN, knows FLANAGAN's reputation for truth, honesty and veracity in business circles (756); that FLANAGAN's reputation for truth, honesty and veracity in business circles is bad (756); that knowing FLANAGAN's reputation, he would not believe him under oath nor would he believe him under any circumstances (758).

FORREST P. CALKINS previously qualified as an expert was examined by defendant and explained that an I. R. S. Form W2 is a form given to employees by the employers showing employee's wages paid for the calendar or taxable year and that the employer is required to, by law, give this to the employee (760-761); that a Form 1099 is an information form indicating that a person or business paid monies of a taxable nature over to a third party taxpayer, such as interest, dividends, commissions, rents where there is no withholding taken from the source and that the payor is required under the Internal Revenue Code to send it to the recipient (761).

V

ARGUMENT

A. DID THE COURT ERR IN FAILING TO RULE ON THE DEFENDANT'S MOTION UNDER RULE 29(a) AT THE CLOSE OF THE GOVERNMENT'S CASE?

Defendant moved for judgment of acquittal based on the lack of showing of wilfulness or specific intent and cited in support thereof the cases of Spies v. United States, 317 U. S. 492, and Holland v. United States, 348 U. S. 121, 139 (494-496). The Court stated, "the motion will stand submitted." (496). Counsel thereupon queried whether an objection should be made at said point inasmuch as the matter had been submitted and the Court replied, "not until I have ruled." (497).

There appears to be some conflict between the circuits as to mandatory applicability of Rule 29(a). In Jackson v. United States, 250 F. 2d 897 (5th Cir. 1958), said Court held that the Court cannot reserve a ruling on a motion at the close of the government's case and reversed the lower Court.

In Cephus v. United States, 324 U. S. 893, District of Columbia Circuit, the Court stated on page 897,

> " . . . but Rule 29(a) of the Federal Rules of Criminal Procedure makes it clear that the first ruling is not discretionary in criminal cases. A judgment of acquittal is mandatory if the Government's case is insufficient. The trial judge has

no discretion to reserve his ruling in the expectation that the defendant will testify (Jackson v. United States, 250 F. 2d 897)."

In the concurring opinion, at page 898, Circuit Judge Wright states,

"Pursuant to Rule 29(a), Federal Rules of Criminal Procedure, appellant moved for judgment of acquittal at the close of the Government's case. Instead of granting the motion, the trial judge made no ruling. Under Rule 29, he was required to rule. And in view of the insufficiency of the evidence then in the record, the motion should have been granted.

"The fact that exculpatory evidence offered by his co-defendant implicated appellant in the crime cannot deprive appellant of its right under Rule 29(a) nor can appellant's effort in introducing evidence on his own behalf to offset his co-defendant's evidence trigger the invocation of the waiver doctrine. Whatever continued validity that archaic doctrine may have, it certainly has no application to the facts of this case. Indeed a simple ruling of Rule 29(a) indicates that the waiver doctrine is without validity in any case. Defendant cannot be boxed out of his Rule 29(a) rights by forcing him to go to trial with a co-defendant or by waiting hopefully for him to convict himself."

In footnotes to the concurring opinion, at page 898, the Court states,

> "The grant of the motion in proper cases is mandatory and not a matter of discretion, for the rule states in terms that the Court, '<u>shall</u>' order the entry of judgment of acquittal . . . if the evidence is insufficient to sustain a conviction. Rule 29(a) (Emphasis supplied.) See <u>Cooper v. United States</u>, 94 U.S. App. DC 343, 218 F.2d 39, 1954. The introduction of evidence after denial of the motion does not 'waive' the motion so as to prevent appellate review of the sufficiency of the evidence. <u>Hemphill v. United States</u>, 312 U.S. 657 (per curiam). If the denial of the motion was erroneous when made, it should be corrected on appeal. Few errors of law are as prejudicial to the defendant. Subsequent testimony cannot 'cure' the error. (See generally the comment: The Motion for Acquittal; A Neglected Safeguard 70 Yale L.J. 1151 [1961])."

But in the case of <u>Weathers v. United States</u> (9th Cir. 1963), 322 F.2d 566, 568, the Court states,

> "Assuming that it is error to reserve ruling on a motion for acquittal at the conclusion of the government's case, and assuming error was not

waived by the introduction of evidence in the defense, such error cannot possibly be considered prejudicial unless the evidence was such that the Court should have granted the motion. . . . If it can be said that passing upon the foregoing direct and circumstantial evidence produced during the government's case in chief, reasonable minds could have found that the evidence excluded every reasonable hypothesis but that of guilt, then the Court should have denied the motion."

In Bolen v. United States, 303 F. 2d 870 at 874, the Court stated,

"The rule for determining the sufficiency of circumstantial evidence on motions for acquittal were stated by this Court in Remmer v. United States, 1953, 9th Circuit, vacated 350 U.S. 377, 76 S. Ct. 425 on other grounds, as follows: 'The test to be applied on motion for judgment of acquittal . . . is not whether in the trial court's opinion the evidence fails to exclude every hypothesis but that of guilt, but whether as a matter of law reasonable minds as triers of the fact must be in agreement that reasonable hypotheses other than guilt could be drawn from the evidence . . . .

If reasonable minds could find that the evidence excludes every reasonable hypothesis but that of guilt the question is one of fact and must be submitted to the jury. ' " (Emphasis supplied).

But in the case of United States v. Rosengarten, 357 F. 2d 263 (2nd Cir. 1965), at page 266, the Court states,

> "It is settled law that the defendant who offers evidence after the denial of a motion for acquittal at the close of the Government's case in chief waives any claim as to sufficiency of that case considered alone. United States v. Calderon, 348 U.S. 160-164, Note 1. We have applied this rule when, as here, the judge ignored the command of Federal Rule of Criminal Procedure 29(a) and reserved decision on a motion (see United States v. Goldstein, 168 F. 2d 666, 669-70, 2nd Circuit 1948) and the Supreme Court's approving citation of the Goldstein decision in Calderon, supra, indicates that it perceives no basis for distinguishing between the two situations, at least in the absence of a demand for a ruling on the motion and explicate refusal by the judge to obey the mandate of the Rule."

Preliminarily, we note that defendant failed to demand a

ruling at the close of the government's case, but we submit that plain error exists here affecting substantial rights which this Court can recognize under Federal Rules of Criminal Procedure, 52(b).

In deciding whether the motion should have been granted, the evidence produced by the government must be competent and relevant. It must be tested under the rules of the Bolen and Remmer cases, cited above, which states that the test is not whether the evidence fails to exclude every hypothesis but that of guilt, but whether as a matter of law reasonable minds as trier of the facts must be in agreement that reasonable hypotheses other than guilt could be drawn from the evidence.

The government has produced evidence as follows:

(1) PHILLIPS first stated that he made loans to the defendant, later recanted and stated in substance, "that the payments were given in appreciation of business. They were not considered too much of a loan; that the defendant still owes him money, although he does not know how much; that they are still open; that he doesn't think they are loans anymore, he thinks they are appreciation for the business we were doing for that company and that the defendant never asked nor mentioned receipt of money as a condition of doing business."

(2) MORRIS RATNER'S testimony was that all of the monies given were loans.

(3) DOUGLAS BROS. PRODUCE CO.'s books showed preliminarily loans, and later charges in their books as Sales

Expense.

(4) The ROYAL PRIME STEER testimony relates to three percent solicited of sales as an "advertising allowance".

(5) The COAST POULTRY records indicate how the payor charged the payments but there is no showing of the reason for the payments over nor a solicitation by the defendant.

(6) The SOUTHERN CALIFORNIA TRADING COMPANY's sum of $225.00 was testified as being a gift by witness JOHNSON who actually caused the same to be drawn and delivered to the defendant.

Further, evidence that these payments were loans or gifts and non-taxable is shown by the fact that the government failed to produce a scintilla of evidence of wilfulness to indicate that defendant knew or should have known that he must report the same on his tax returns.

No evidence of specific intent to evade the tax, or the aspect of wilfulness can even be inferred from the government's case in chief. For instance, there is no showing of why Forms W-2 or Forms 1099 were not sent as required by law from the purveyors in question. No evidence was introduced that defendant knew by act, declaration or omission that the funds received were taxable income from any of the direct and circumstantial evidence introduced. No rebates or commissions or gratuities were asked for by defendant of any of the government's witnesses.

The government contends that W-2's and 1099 forms could not be sent since the purveyors would be acknowledging that they

were involved in illegal rebates.

It is to be noted further that the section relating to kickbacks as cited in the government's Trial Memorandum, to-wit, the Packers and Stock Yard's Act, Title 7, United States Code, Section 181, et seq. (CT 25-6), would not be applicable to vegetable products or seafood items. This eliminates the illegality aspect of the vegetable purveyor DOUGLAS BROS. and Seafood Broker SOUTHERN CALIFORNIA TRADING COMPANY. Based on the above test in the light of the state of the evidence of the government's witnesses as to its case in chief and testing the evidence against the rules set forth in Bolen v. United States, supra, in viewing the evidence in the light most favorable to the government including inferences to be drawn therefrom, it is submitted that there is no scintilla of evidence to show specific intent, wilfulness or knowledge of the necessity to report the monies received on the part of the defendant, independent of or from the testimony adduced that the payments were, in fact, anything other than gifts or loans. Indeed, the government has even failed to show that the monies received by the defendant are even income.

B. DID THE COURT ERR IN ALLOWING THE JURY TO SEPARATE AFTER IT BEGAN ITS DELIBERATIONS?

On June 13, 1967, at 4:45 P. M., after the jury had deliberated for approximately 2-1/2 hours, Court reconvened, the jury was admonished and was separated for the evening with directions

to return directly to the Jury Room the following morning at 9:30 A. M. and resume its deliberations (869).

Counsel were not beforehand advised by the Court that it intended to separate the jury nor asked for a stipulation to allow the jury to separate or invite any objections to its actions. Defendant asserts that due to the abrupt termination of the proceedings and the adjournment and the separation of the jury that the defendant was unable to place in the record an objection then or the following morning prior to the resumption of deliberations since the Court did not reconvene until 11:30 A. M. when it re-read further instructions on intent.

In the case of United States v. D'Antonio, 342 F. 2d 667 (7th Cir.), at page 669, the Court stated,

> "It is the right of the defendant when upon trial of a charge of the commission of the felony to have his case decided by a jury whose secret deliberations are not interrupted by the Court's order permitting them to separate before a verdict has been reached. Historically, this is a right recognized for many years. . . . "

At page 670, it further states,

> "At no time is it more essential that the jury should be immunized from outside influences then when it is engaged in deliberating upon what its verdict is to be. During that critical period, when the jurors are engaged in resolving vital

issues between the government and the defendant, the judge certainly should not relax the traditional safeguards against outside intrusion. Disbursement into the city at night of a group of men and women who have been deliberating in the security of the Court House subjects them to the risk of being individually importuned, if not threatened, by telephone calls or personal contact."

Said Court reversed the trial court for permitting a separation over objection for permitting the jury to separate after beginning deliberations, and for failing to give precautionary instructions upon so doing, and in permitting the U. S. Marshal to communicate with the jury without defense counsel being advised.

In Cavness v. United States, 187 F. 2d 719 (9th Cir.), which is apparently the only Ninth Circuit case ruling on this point, at page 723, this Court stated,

> "Separation of the jury in such a way as to expose them to tampering or any improper influence after a criminal case has been submitted to them is reversible error (See Mattox v. United States, 146 U.S. 140, 149). 'Private Communications possibly prejudicial, between jurors and third persons are also error' (146 U.S. at page 150). But the error is not reversible if it appears that no prejudice in fact resulted. U.S. v. Reid, 53 U.S. 361, 366.

Stone v. United States, 113 F. 2d 70, 77-78. Bilodeau v. U.S., 14 F. 2d 582, 586, Cert. denied, 273 U.S. 737. Unless as a matter of policy prejudice must be conclusively presumed, as whether irregularity 'has tainted the panel with sort of corruption or intimidation or coercion'. Klose v. United States, 49 F. 2d 177, 181, Cert. denied, 284 U.S. 626."

In the Cavness case, the error complained of resulted where a juror made a telephone call accompanied by a deputy marshal. During his separation, the jury at no time received any communication about the case from anyone, and both juror and marshal were presumed to have faithfully performed their official duty and the trial court found no prejudice to appellant warranting a new trial.

We distinguish the case of Cavness from the D'Antonio case, since in Cavness the juror was at all times accompanied by an officer of the court while making his telephone call. In the D'Antonio case the jurors were separated and allowed to go home or elsewhere unaccompanied by any officer of the court and for a period in excess of eight hours as in the case at bar.

The fact that no objection was raised, prior to the separation, or at the first opportunity thereafter, would normally not appear to be a waiver of the objection since it is asserted that such waiver must be an informed and knowing consent and should be

expressly waived rather than presumed.

In connection with the policy relating to prejudice, it is asserted that the risk of being importuned after having received all of the evidence of a particular case by any contact other than other jurors, could knowingly or unknowingly influence and motivate the juror, and said risk outweighs any other consideration and may be presumptively prejudicial.

In the light of the rules regarding impeaching of jury's verdicts by foreclosing the use of jurors' affidavits to impeach its own verdict, it is only fair that the presumption of prejudice to the defendant should attach, and the government should be required to show that no prejudice in fact accrued, rather than to cast such an onerous burden on the defendant.

As to whether the court did properly exercise its discretion in separating the jury in the absence of objection or express waiver with proper admonitions to the jurors, we submit that in the light of mass communication media, including radio, television and newspaper, the risk of direct and indirect contacts and the fact that the door is open to such contacts for even innocent reasons, such events are not taking place in a vacuum but within an interplay of personal and public contacts. It is asserted that the test should not be whether the discretion of the court was properly exercised, but whether the risk of exposure to the potential influence of any such contact by the jury could affect the juror's decision to the prejudice of either party.

C. DID THE COURT ERR IN FAILING TO GIVE THE COMPLETE "ALLEN INSTRUCTION" SO AS TO PREJUDICE DEFENDANT?

On June 13, 1967, at approximately 2:15 P. M., the instant case was given to the jury for its deliberations (868). About 4:50 P. M. on said date, the jury was allowed to separate until 9:30 A. M., June 14, 1967 (869). At approximately 11:30 A. M. on June 14, 1967, certain instructions on intent were repeated to the jury pursuant to their request (872-78). At approximately 2:45 P. M. on June 14, the Court, upon learning that the jury was having difficulty in reaching the verdict, gave most of the supplemental instruction from Mathis & Devitt, No. 15.16.

The alleged error, asserted here, is in the failure of the Court to give the following phrases from said instruction:

> "Remember too, if the evidence in the case fails to establish guilt beyond the reasonable doubt, the accused should have your unanimous verdict of 'not guilty'. Above all, keep constantly in mind that unless your final conscientious appraisal of the evidence in the case clearly requires it, the accused should never be exposed to the risk of having to run twice, the gauntlet of a criminal prosecution; and to endure a second time the mental, emotional and financial strain of a criminal trial. . . . You may be as leisurely in your

deliberations as the occasion may require; and you shall take all the time which you may feel is necessary."

The subject instruction is the so-called "Allen Instruction" taken from Allen v. United States, 164 U.S. 492, 501. Within the Ninth Circuit, the instruction was given and approved in the case of United States v. Kawakita, 190 F.2d 506, affirmed 343 U.S. 717, and in Shea v. United States, 260 Fed. 807, 808-810.

In the case of Berger v. United States, 62 F.2d 438, where the Court reversed the trial court for inquiring as to the numerical division of the jury, at page 440, the Court stated,

> "We are further of the opinion that where a Court gives a supplemental charge of the character given in the instant case (even where it omits the inquiry as to how the jury stood numerically), it should again call the jury's attention to the presumption of innocence, the burden of proof, and the requirement that guilt must be established beyond a reasonable doubt; and it should state that it is the duty of each juror to perform his duty honestly and conscientiously according to the law and the evidence, and not to surrender his conscientious convictions. Such supplemental charges are calculated to wrongfully coerce the jury unless properly safeguarded. Stuart v. United States, 300 Fed. 769, 785. (An approved

charge so safeguarded may be found in United States v. Allis, 73 Fed. 165)."

Here, we submit that the omitted portion of the supplemental instruction is the balancing factor in the instruction, in that it reminded the jury as to the government's burden of proof, and that the accused should not, unless required, be exposed to the risk of a second criminal prosecution or the mental, emotional and financial strain thereof, and that the deliberations of the jury may be as leisurely as the occasion may require. Such omission, we submit, causes an unbalancing and a one-sided version of the so-called Allen charge to the prejudice of the defendant.

In United States v. Smith, 353 F.2d 166 at page 168, in the Fourth Circuit, the Court stated,

> "Almost as the outset the district judge stated, 'while undoubtedly the verdict of the jury should represent the opinion of each individual juror . . . '; he did not otherwise inform the jurors of their duty to dissent if dissent is founded upon reasons, conclusions, reasonably arrived at and reasonably held (U.S. v. Rodgers, 298 F.2d 433, 436). It was not an adequate exposition of that ameliorating admonition which makes tolerable the charge upon the duty of individual jurors finding themselves in the minority to re-examine their views in the light of those of the majority and of

their paramount duty of agreement."

It is noted that under Rule 30, Federal Rules of Criminal Procedure, that an objection to the charge must be made at the time it was given. However, in the instant case, counsel were not apprised beforehand that the "Allen" charge or supplemental instruction would be given, and we are not here urging error on the part of the Court which in its discretion can and did give the charge. The basis of the asserted error is the fact that the Court omitted to give the entire charge. In view of the fact that the jury had been deliberating approximately ten hours over a 30 hour period at the time the supplemental instruction was given, and due to the apparent inability of the jury to agree, the failure to give the omitted portion of the instruction which can be construed to be favorable to the defendant, the scales were tipped in favor of the government and to the prejudice of the defendant.

We also assert that this type of asserted error is such plain error as would come within the ambit of Rule 52(b) of the Federal Rules of Criminal Procedure.

D. IS THE VERDICT CONTRARY TO THE WEIGHT OF EVIDENCE?

As set forth in Section A above (pages 34-41) hereto, defendant asserts that evidence of wilfulness is not supported by the evidence, either in the government's case in chief, or construing

the evidence as a whole.

"A final element for conviction is wilfulness. The petitioner contends that wilfulness involves a specific intent which must be proven by independent evidence and which cannot be inferred from the mere understatement of income. This is a fair statement of the rule."

Holland v. United States, 348 U.S. 121, 139.

"Wilfulness involves a specific intent which must be proved by independent evidence and which cannot be inferred from the mere understatement of income. Holland v. United States, 348 U.S. at p. 139. The test of wilfulness is quite fully discussed in Spies v. United States, 317 U.S. 492, 499. Wilfulness involves a state of mind. Direct proof of wilfulness is seldom available. A consistent pattern of under reporting large amounts of income or over-claiming deductions and not recording such items on the taxpayer's records is evidence from which wilfulness may be inferred. (Holland v. U.S., 348 U.S. 121. Zacher v. U.S., 277 F.2d 219, 244. Canton v. U.S., 226 F.2d 313, 321) citing from Blackwall v. U.S., 244 F.2d 423, 429.

"Direct proof of wilful intent is not necessary. It may be inferred from the acts of the parties and

such inference may arise from a combination of acts, although each act standing by itself may seem unimportant. It is a question of fact to be obtained from all the circumstances (citing cases)."

Battjes v. United States, 172 F.2d 1, 5.

"Affirmative wilful attempt may be inferred from . . . , any conduct, the likely affect of which would be to mislead or to conceal."

Spies v. United States, 137 U.S. 499.

"Appellant argues in his reply brief that even if there was sufficient evidence to show a tax deficiency, there was no evidence of fraud. A state of mind can seldom be proved by direct evidence, but must be inferred from all the circumstances. A wilful intent to evade income taxes may be inferred from such factors as appellant's failure to include a substantial amount of income on his and his wife's tax returns, the failure to keep adequate books which would clearly reflect income, and the concealment of the ownership of property, such as the safe-deposit box, real estate interests and business licenses. These factors, all present in the instant case, are but part of a general pattern of conduct engaged in by the

appellant from which the jury could infer the requisite intent."

(See Norwitt v. United States, 195 F.2d 127, 132.)

Remmer v. United States, 205 F.2d 277, 288.

"It is now settled that, 'wilfully' as used in this offense means more than intentionally or voluntarily, and includes an evil motive or bad purpose, so that evidence of an actual bona fide misconception of the law, such as would negative knowledge of the existence of the obligation, would, if believed by the jury, justify a verdict for the defendant."

Wardlaw v. United States, 203 F.2d 884, 885.

In accord, United States v. Murdock, 290 U.S. 389;

Hargrove v. United States, 67 F.2d 820;

Haigler v. United States, 172 F.2d 986;

Battjes v. United States, 172 F.2d 1;

Gaunt v. United States, 184 F.2d 284.

Based on the above cited authorities, we submit that the government's case in chief, failed to show the requisite wilfulness, and the evidence as a whole adds nothing to the government's case as to this basic requirement for conviction.

The fact that the jury, in acquitting the defendant for the years 1960 and 1961, based on almost identical substantive proof,

indicates further that the jury was unconvinced as to this element.

CONCLUSION

It is respectfully submitted that the conviction of the defendant herein for the years 1962 and 1963 (Counts III and IV) of the subject indictment be reversed or in the alternative that this case be remanded for a new trial for the reasons set forth above.

Respectfully submitted,

MORI & KATAYAMA

By: ARTHUR S. KATAYAMA

Attorneys for Appellant

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Arthur S. Katayama

ARTHUR S. KATAYAMA

NO. 22193

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN L. SULLIVAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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APPELLEE'S BRIEF

I

JURISDICTION AND STATEMENT OF THE CASE

This is an appeal from a judgment of conviction on two counts of a four count indictment which was returned by the Federal Grand Jury for the Southern District of California, Central Division, on December 14, 1966 [C. T. 2-6]. 1/

Each count alleged a violation of Title 26, United States Code, Section 7201, wilful attempt to evade and defeat income tax for the years 1961, 1962, 1963 and 1964, respectively.

1/ C. T. refers to Clerk's Transcript of Record.

On January 16, 1967, a motion to suppress evidence was filed by appellant. Hearing on the motion was held on June 6, 1967 [R. T. 73]. 2/ The motion was held in abeyance by agreement of the attorneys for appellant and appellee [R. T. 100].

On June 6, 1967, a jury trial commenced before the Honorable Jesse W. Curtis, United States District Judge [R. T. 102]. On June 8, 1967, the government rested its case-in-chief and appellant moved for a judgment of acquittal [R. T. 494], which motion was taken under submission [R. T. 496]. The motion was renewed at the close of all evidence and denied by the court after jury verdict on June 14, 1967 of Not Guilty on Counts One and Two, and Guilty on Counts Three and Four [C. T. 56, 57]. Appellant's motions to set aside the verdict and for judgment of acquittal or new trial were denied [C. T. 60, 70].

On July 28, 1967, appellant was sentenced to a term of imprisonment for two years, execution of which was suspended and appellant placed on two years probation on condition he serve thirty days in a "jail-type" institution [C. T. 80].

Appellant filed a timely notice of appeal, and is at liberty on appeal bond [C. T. 101].

Jurisdiction of the District Court was predicated on Title 26, United States Code, Section 7201. This Court has jurisdiction to entertain this appeal under the provisions of Title 28, United States Code, Sections 1291 and 1294.

2/ R. T. refers to Reporter's Transcript of Proceedings.

II

STATUTE INVOLVED

Title 26, United States Code, Section 7201 provides in pertinent part:

> "Any person who wilfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall . . . be guilty of a felony and upon conviction thereof shall be fined not more than ten thousand dollars ($10,000) or imprisoned not more than five years, or both, together with the cost of prosecution."

III

STATEMENT OF FACTS

Appellant was employed as the Executive Chef of the Gourmet Restaurant in the Disneyland Hotel since approximately 1957 [R. T. 139]. This is a position of great responsibility with supervision of over 100 employees [R. T. 151]. Of primary importance to the issues in this case is the fact that with minor limitations appellant had the responsibility for buying the foodstuffs for the restaurant and more importantly, discretion to pick and choose the supplier or purveyor of these foodstuffs [R. T. 152]. During the indictment years the sole source of income reported by appellant was the salary received by virtue of his position [R. T.

[illegible]

[illegible]

[illegible]

[illegible]

130].

The evidence established that for the indictment years appellant received additional unreported taxable income from at least six purveyors. This taxable income was paid by the purveyors for the business which they had received and were to receive from the appellant in his capacity as buyer for the Gourmet Restaurant. The proof [Ex. 72] established the following income:

	Reported	Corrected
Taxable Income 1960	$ 7,332.36	$14,440.26
Taxable Income 1961	$ 7,806.45	$15,117.01
Taxable Income 1962	$ 6,952.66	$14,996.12
Taxable Income 1963	$ 8,708.17	$14,758.08
TOTAL	$30,799.64	$59,321.47
Income Tax 1960	$ 1,759.70	$ 4,466.92
Income Tax 1961	$ 1,901.94	$ 4,784.99
Income Tax 1962	$ 1,645.80	$ 4,728.18
Income Tax 1963	$ 2,200.77	$ 4,616.30
TOTAL	$ 7,508.21	$18,596.39

The method of proof utilized in this case was the specific items method concerning payments received from certain purveyors as follows:

1. Harry Phillips of Phillips Poultry testified to his payments of money to appellant. These financial transactions started in about 1957 [R. T. 168]. Initially appellant requested

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[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]

[illegible]

[illegible]

loans from Mr. Phillips and in fact in those early years made some minimal repayments. With the passage of time, however, appellant no longer made requests for money nor were there any conversations at all concerning the payments. Instead a pattern developed of payments by Mr. Phillips with a degree of regularity which approximated the business that Phillips Poultry was receiving in orders of merchandise from appellant [R. T. 196, 198]. Mr. Phillips had sole responsibility for the amount of the payments and utilized as criteria approximately 30 cents per case of eggs and approximately 3% for the remaining business [R. T. 218]. He mailed these payments approximately once a month to appellant. As Mr. Phillips made clear, this method of payment commenced in 1960 and there was no illusion of repayment [R. T. 216]. The payments were given solely in "appreciation of business" and in lieu of salesmen's commission [R. T. 228].

It is to be noted that the Government's computations of unreported taxable income include only those payments starting with the period of time when there was no longer any illusion of the existence of a possibility of loans. All prior payments made under the "guise of loan transactions" were eliminated from consideration in the indictment.

2. Dean Flanagan was sales manager of Royal Prime Steer in the year 1959, when he had his first contact with the appellant. Mr. Flanagan testified to a meeting wherein the appellant referred to the fact that salesmen usually receive approximately 3% of the gross purchases and it is not always

necessary to have salesmen for this type of transaction [R. T. 375]. Mr. Flanagan stated that this was a matter which would have to be discussed with his employers and shortly thereafter Royal Prime commenced payments to the appellant. Approximately once a month Mr. Flanagan would receive from Mr. Holman, the bookkeeper [R. T. 378], a sum of cash which constituted 3% [R. T. 361] of the gross sales to Gourmet Restaurant which was delivered by Mr. Flanagan to the appellant [R. T. 374]. This procedure continued until the last indictment year when Mr. Flanagan who had by then acquired voting control of the company handled the matter by paying to appellant the proceeds of a bonus check Flanagan had received from Royal Prime Steer [Ex. 60, R. T. 380]. Thereafter Mr. Flanagan,who disapproved of this type of practice,stopped making payments to appellant [R. T. 403]. It is interesting to note that concurrently appellant ceased ordering merchandise from Royal Prime Steer [R. T. 382].

The only "evidence" which the appellant produced at trial to support his contention that these payments were loans, part of which were repayed to Mr. Flanagan is a counter check. The proceeds of this check were assertedly given to Mr. Flanagan. However, Mr. Flanagan did not enter the bank or endorse the check [R. T. 748-50]. No explanation was given as to why appellant used such a counter check, payable only to the maker, instead of writing a personal check or using one of the blank checks which banks keep on hand.

3. Appellant also received sums of money from the

Coast Poultry Co., also a supplier. These sums of money were paid to appellant by George Cinquini, the owner of Coast Poultry, who was deceased at the time of trial. The payments from Coast Poultry were in two forms, a series of checks payable to the appellant which were covered by a series of five notes of indebtedness totalling $3,900 [R. T. 243]. The balance of payments to appellant were checks drawn on Coast Poultry business account and charged on the books and records to "Purchases and Commissions" [R. T. 713]. Those payments covered by the five notes were not included in the Government's computations or charge of unreported income. It is to be noted that the collection on the notes had not been made and the notes were uncollectible at the time he was first contacted by IRS agents since barred by the statute of limitations. However, following appellant's being contacted by Internal Revenue Agents [R. T. 419] relative to his failure to pay tax on kickbacks and being informed by other sources that he was under investigation for income tax evasion, appellant signed some of the notes reinstating their collectibility [R. T. 254].

4. In 1963, according to the testimony of Louis Johnstone [R. T. 520], Southern California Trading Company found itself saddled with a very large amount of lobster. Hard pressed to dispose of the lobster, Mr. Johnstone recruited several chefs, including appellant, as salesmen [R. T. 524]. As a result of appellant's efforts in this regard, he received a check for $225 (Ex. 45). This amount was not reported on appellant's return for

that year. Mr. Robert Joyce, president of Southern California Trading stated that this definitely was not a loan [R. T. 282] or a gift [R. T. 297]. Following this transaction, Mr. Johnstone introduced appellant to Mr. Joyce at the Chevy Chase Country Club [R. T. 528]. Thereafter, Joyce "loaned" appellant $1,000 for which a note was taken back (Ex. D). It was marked paid. The $1,000 was recorded on the company notes receivable ledger, then crossed off mysteriously, to reappear in the sales ledger credited to "disct" [R. T. 283]. The change was made after Mr. Joyce had left his job [R. T. 294].

5. Albert R. Hazen, accountant for the Douglas Brothers Produce Company, a purveyor, testified that $3,200 paid to appellant in checks from Douglas Brothers (Ex. 49-52) had been entered on the company books as a bad debt write-off [R. T. 330]. Nick Douglas, one of the principals of Douglas Brothers, refused to answer questions about payments to appellant, claiming the privilege against self-incrimination [R. T. 501].

Furthermore, in the years 1962 through 1965, appellant owned no car [R. T. 633]. Instead, he drove a car which was furnished him by Douglas Brothers Produce, and which was at all times the property of Douglas Brothers [R. T. 627]. In the year 1963, however, appellant took a depreciation deduction on the car. This was admitted to by appellant under oath in the course of the trial [R. T. 636].

6. Appellant also received substantial sums from the Ratner Brothers Meat Company, who were suppliers. Beatrice Ebeling,

bookkeeper testified that payments were made to appellant in 1961 (Ex. 32) which were recorded as "food consultant fees" [R. T. 267] at the instruction of Mr. Morris Ratner [R. T. 271]. Such food consultant fees were paid for expert advice on such matters as cutting techniques, portion control, etc. [R. T. 272]. Clearly this is taxable compensation for a service.

Other payments were made to appellant which totaled $12,000 (Ex. 36, 38-44) by Mr. Morris Ratner personally. Mr. Ratner was called as a witness of the court, for the reason that the Government was unwilling to vouch for his credibility. Mr. Ratner testified that the money was always in the form of loans. It was always in cash, and notes were not taken for the "loans". Appellant testified that he had known Ratner for some time, but admitted that the relationship had lapsed. It had been renewed at the time appellant began his purchasing duties [R. T. 586]. He also stated that he was required to pay back each "loan" before a new one was granted. This was impeached when it was demonstrated that in a three week period in 1961, three "loans" had been made totalling $850 [R. T. 319].

These payments were part of a pattern which was utilized by appellant apparently as a means of securing funds for his admittedly uncontrollable gambling habit [R. T. 575]. A compelling motive for the purveyors to attempt to camouflage the payments, which were in fact kickbacks has been suggested: Such payments are prohibited under heavy penalty by federal law, 7 U. S. C. 181, with respect to most of the payors.

This pattern of payments existed well prior to 1959. For example, appellant testified [R. T. 674, 187, 689] that he had gotten "loans" from Douglas Brothers Produce, George Phillips and Morris Ratner from 1957 on. The loans from Ratner were assertedly each paid before another was granted. The others were repaid "spasmodically" [R. T. 676]. Mr. Ratner testified that such loans were made on a more or less monthly basis [R. T. 318]. The Government, however, impeached this assertion by demonstration that in one three week period in 1961 three payments totalling $850 had been made to appellant [R. T. 319].

Notwithstanding this testimony, a sworn statement was introduced into evidence, used in 1959 to support a petition in bankruptcy (Ex. 61) in which appellant listed no past debts or payments to any purveyor, including those in question [R. T. 700-703]. Appellant confirmed that he did in fact make this damaging omission [R. T. 707]. According to appellant, the reason why he filed bankruptcy was because he was unable to satisfy a $5,000 judgment rendered against him as a result of an auto accident.

Appellant's response to this demonstrated pattern of payments from individuals who he knew in a business context only was to make a number of bare assertions attacking the integrity of the payors [R. T. 269] especially Mr. Dean Flannagan. It was alleged that Mr. Flanagan was in fact repaid, but that he kept the money and used it to buy control of Royal Prime Steer [R. T. 815]. In addition, a witness was produced who stated that he was a "meat man", and that Mr. Flanagan's reputation is "bad". No

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factual support for this conclusion was given [R. T. 752]. Likewise without factual support, another witness appeared who testified that Mr. Flanagan could not be taken at his word [R. T. 755].

IV

ARGUMENT

A. THE TRIAL COURT DID NOT ERR IN RESERVING RULING ON APPELLANT'S MOTION FOR JUDGMENT OF ACQUITTAL MADE AT THE CLOSE OF THE GOVERNMENT'S CASE-IN-CHIEF.

At the close of the Government's case, appellant moved for a judgment of acquittal under Rule 29, Federal Rules of Criminal Procedure (18 U.S.C.A.) on the theory that the Government had failed to make a prima facie showing that appellant had wilfully and with specific intent to do so evaded payment of income tax in violation of 26 U.S.C. 7201 (1964), citing _Spies_ v. _United States_, 317 U.S. 492 (1942); _Holland_ v. _United States_, 348 U.S. 121 (1954). The court did not rule forthwith on the motion, but announced that the motion would stand submitted [R. T. 496].

Appellant contends that it was incumbent on the court to rule on the motion, and that its reserving judgment was reversible error, following his particular interpretation of _Jackson_ v. _United States_, 250 F.2d 897 (5th Cir. 1958).

Rule 29 creates the right in federal criminal defendants to

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make a motion for judgment of acquittal either at the close of the government's evidence or at the close of all evidence. There is no express language in Rule 29 forbidding the court from reserving judgment when the motion is made at the close of the government's evidence, and such reservation is expressly permitted when motion is made at the close of all evidence.

Unlike the civil motion for nonsuit, granting of the motion is mandatory where the government has rested without making out by its own evidence a prima facie case of defendant's guilt. "The requirement that such a (prima facie) case be made before the accused be put to his defense is one of the great safeguards in our system of justice." Bazelon, J., in Cephus v. United States, 324 F.2d 893, 895 (D.C. Cir. 1963). It is recognized that it is manifestly unfair for the government to put on a sham case, and then hope for the accused to convict himself; for if this were permitted there would be a return to the infamy of inquisatorial justice.

The facts of the Cephus case, unrelated in appellant's brief, which was cited for the proposition that ruling is "mandatory", were of an entirely different quality than those in this case. There, the accused was convicted of car theft on no more evidence than a single fingerprint found on the outside of the car's window. Ruling on a motion under Rule 29 was reserved, and the defense proceeded. The accused was convicted after the jury believed exculpatory testimony by an alleged accomplice which implicated Cephus.

Applied to the facts therefore, the holding in Cephus is properly interpreted to mean that it is mandatory to grant the motion when it does not appear that a reasonable man could find guilt beyond a reasonable doubt, based on the government's evidence alone. If there was evidence which is sufficient to present to a jury, the motion cannot lawfully be granted. The utmost care should be exercised in granting the motion, for there is currently no appeal from a judgment of acquittal. The Motion for Acquittal, A Neglected Safeguard, 70 Yale L. J. 1151 note 61 at 1161 (1961); Kepner v. United States, 195 U. S. 100 (1904); Greene v. United States, 355 U. S. 184 (1957).

Only where there is no doubt in the court's mind that the accused cannot be guilty beyond a reasonable doubt may the case be taken from a jury. Cooper v. United States, 218 F. 2d 39 (D. C. Cir. 1964). Moreover, in resolving any factual ambiguities in deciding a motion under Rule 29 the court is enjoined to view the evidence in a light most favorable to the government. United States v. Frank, 151 F. Supp. 866 (D. Pa. 1957), aff'd. 245 F. 2d 284, cert. denied 355 U. S. 819.

The facts in the Frank case, supra, provide a useful contrast to the Cephus case. There, as here, the accused was charged with evasion of income tax. The government's evidence was a series of bank deposits of unascertained origin the amount of which were far in excess of defendant's reported income. Motion for judgment of acquittal was made at the close of the government's case, ruling on which was reserved for the reasons

outlined above, though the evidence was indirect as it was here. 151 F. Supp. at 868. The Frank court correctly decided that the government was not required to conclusively negative every possibility that the money came from a non-taxable source, i.e., gift, loan, in order to withstand the motion (citing Holland v. United States, 348 U.S. 121 (1954)). A sufficient prima facie case was made out by showing that the money in excess of reported income had been deposited in banks. An analogous showing was made by the government in this case, and it properly was allowed to withstand the motion.

It is clear from the record that the government's evidence was of quality far exceeding a mere fingerprint. Witnesses were produced who though hostile in all cases save one testified to a complex web of transactions in which appellant received several thousand dollars. These transactions were shown to have been carried out in ways systematically calculated to befuddle the government's assessment of tax thereon. In addition, it was shown that appellant was impoverished due to heavy (non deductible, 26 U.S.C. 165d) gambling losses [R. T. 575].

In both this and the Frank case, supra, the issue was whether the transacting parties intended the payments to be income, i.e., not a gift or loan, etc., and whether there was a wilfull attempt to avoid payment of taxes due thereon. Spies, supra. Such questions can only be answered when the jury weighs evidence, and assesses credibility of witnesses. Weathers v. United States, 322 F.2d 566 (9th Cir. 1963); Rowe v. United States, 370 F.2d

240 (D.C. Cir. 1966). It is not for the court to assume these functions where there is a jury. Riggs v. United States, 280 F.2d 949 (5th Cir. 1960). It is not a requirement that the evidence compel conviction to withstand the motion. Crawford v. United States, 375 F.2d 332 (D.C. Cir. 1967).

It is reversible error to reserve judgment on a motion under Rule 29 only when weaknesses in the government's case make granting of the motion mandatory. In cases such as this where the motion may be lawfully denied, the court is conferring a favor on the accused by reserving judgment, agreeing in effect to stop the trial at any point when it becomes clear that the government cannot prevail. The accused should not be heard to complain of the court's magnaminity.

Where a prima facie case has been made, therefore, the considerations which led the Fifth Circuit to reverse the trial court's reservation of judgment in Jackson v. United States, 250 F.2d 897 (5th Cir. 1958) are not present. We draw the court's attention to the special concurrence of Rives, J., 250 F.2d at 901, substantially in accord with our analysis.

In Jackson, the Fifth Circuit assumed, citing T'Kach v. United States, 242 F.2d 937 (5th Cir. 1957) that the introduction of evidence by the accused after denial of the motion waives any error. That court apparently analogized the motion for judgment of acquittal to the (discretionary, F.R. Civ. P. 41b) civil motion for nonsuit, 70 Yale L.J. 1151, 1158, op. cit., and concluded that error would be waived by presentation of evidence. This

would make the right to put on evidence after denial of the motion (not present in civil cases under F. R. Civ. P. 41b) meaningless, in the Jackson court's opinion. Subsequent cases have begun to make the analytical distinction between civil and criminal cases and the waiver doctrine has been qualified in certain contexts. Cephus, supra. Thus, the dilemma feared in Jackson is less than immediate.

Furthermore, the Advisory Committee on Rules did not have the waiver question in mind when Rule 29 was revised, but was rather concerned that the accused might estop himself, following the civil practice, from making a defense if a motion under Rule 29 was denied. Footnote 3 to Rule 29, 18 U.S.C.A. (1964).

The primary purpose of Rule 29.

Indeed the main purpose of a motion under Rule 29, aside from that pointed out by Judge Bazelon, is to furnish a basis for appellate review of the sufficiency of the evidence. Piccuro v. United States, 250 F.2d 585, 589 (8th Cir. 1958); Janko v. United States, 281 F.2d 156 (8th Cir. 1960). It has been held that the evidence cannot be reviewed unless the motion is made. Corbin v. United States, 253 F.2d 646 (10th Cir. 1958). This function can be amply fulfilled by a motion made at the close of all evidence which is what appellant in fact did [R. T. 766]. The effect of denial of the motion at the close of the government's case has the net effect of reserving judgment until that time, but would not be covered by the Jackson mandatory ruling doctrine. It should make no difference that the court accomplished the same result by

[illegible]

announcing it was doing just that.

If this Court determines there should be a right to a definative ruling on the motion when made at the close of the government's case-in-chief in all cases, despite the fact the government has made a prima facie case, an alternative reason why the trial court did not err in taking the motion under submission was that appellant did not insist on a ruling and an explicit refusal. By failing to timely object to a lack of ruling [R. T. 497], and then proceeding to introduce evidence, appellant waived the motion. United States v. Rosegarten, 357 F. 2d 263 (2nd Cir. 1960); United States v. Goldstein, 168 F. 2d 666 (2nd Cir. 1948). This is not a contradiction of Cephus, supra, for the facts did not make granting of the motion mandatory.

The motion cannot be granted at an early stage except in extraordinary cases for the reasons stated above. To hold that it must be granted in cases such as this where much of the evidence is intangible and in which all but one witness was hostile with one taking the Fifth Amendment [R. T. 499] would be a clear miscarriage of justice, as well as an overturning of settled law. Frank, supra. It would tend to allow defendants to defeat charges by a Rule 29 motion if he is able to manipulate evidence or is well enough acquainted with the witnesses as to be able to color their testimony to a sufficient degree. The District Court did not err in reserving judgment.

B. THE DISMISSAL OF THE JURY FOR THE NIGHT BY THE TRIAL COURT DID NOT CONSTITUTE REVERSIBLE ERROR UNDER THE CIRCUMSTANCES.

On June 13, 1967 at 4:45 P.M., after the jury had deliberated for approximately two and one half hours, Court reconvened, and over no objection the jury was duly admonished and separated for the evening and instructed to return to the jury room at 9:30 A.M. the following morning [R. T. 869]. Appellant contends that because of this, his conviction must be overturned. The government does not agree.

It is incontestable that a jury must be protected from improper outside influences during its deliberations. However, it does not follow that the only way to accomplish this end is the closeting of jurors. In the case of United States v. D'Antonio, 342 F.2d 667 (7th Cir. 1965), upon which appellant chiefly relies, the accused's conviction for theft was reversed after the trial court allowed the jury to separate for the night with admonition delivered by a U. S. Marshal. In addition to primarily denouncing the delegation of judicial duty to a Marshal, the Seventh Circuit opined that historically, it has been a right for a defendant to have his case decided by a jury whose deliberations are uninterrupted by separation prior to reaching a verdict.

Dissenting, Swygert, J., interpreted the court as holding that under no circumstances may a jury be permitted to separate for the night. He astutely noted the majority's failure to deal

adequately with the case of Lucas v. United States, 275 U.S. 405 (8th Cir. 1921). There, the Marshal allowed the jury to separate when he was unable to find adequate quarters for them. The court held this not to be prejudicial error since there was good reason for the separation. The D'Antonio majority cited and approved of Lucas. What the Seventh Circuit failed to do was consider how the separation in the instant case was more likely to lead to prejudicial influence on the jury than in Lucas.

The D'Antonio court also distinguished the case of Holt v. United States, 218 U.S. 245 (1910), which held that separation during the trial, i.e., before deliberations began, was permissible. It was said that this did not authorize separation during the "final and critical phase of the jury's service", 342 F.2d at 669. The court went on to say that a trial judge can manipulate the timing of a trial to an extent that separation can usually be avoided. Thus it is suggested that the court should have adjourned at the close of arguments and reconvened the next day to charge the jury.

Can it be said that a jury is somehow less susceptible to outside influence if it goes home at the close of evidence but before charge than it would be if it had gone home after being charged? If anything, the reverse is true, for, after having been charged the jury has at least had the benefit of an interpretation of the case by an impartial and learned judge, which would surely aid jurors in warding off any importunements from uninformed outsiders. Without a charge, they are at the mercy of their own inexperience. Thus, D'Antonio has a self-defeating effect, if its

goal is to protect jurors from being biased through outside contacts. We submit that another line of analysis should be employed to reach a sound decision on this issue, which is proposed below. "History" should not be blindly followed when there is no reason to do so.

In the case of Cavness v. United States, 187 F.2d 719 (9th Cir. 1951), the error complained of was that a juror had been permitted to leave the deliberations to make a telephone call, in the company of a U. S. Marshal. In response to these urgings, this Court stated that the separation of a jury in such a way as to expose it to tampering or improper influence is reversible error (emphasis added). The court went on to say that private communication between a juror and third person is error, but not reversible if it appears that no prejudice resulted unless, as a matter of policy prejudice must be conclusively presumed; as where irregularity has tainted the panel with any sort of corruption or coercion. It was felt that when the juror took his oath, he was entitled to the presumption that he had performed his duties faithfully, and that an appellate court should be slow to impute disregard of these obligations to a juror.

Moreover, the court did not think it important that the juror may have received some casual communication from a third party about the case, for the reason that any irresponsible views that might have been so proposed would not survive the independent evaluation of the other eleven. We do not think the fact that the juror was in the company of a Marshal was determinative, as

appellant suggests, for the Marshal was not supervising the telephone conversation.

It is our opinion that this Court has adopted a view, much more complimentary to the character and intelligence of jurors, which is contrary to the historical, anachronistic assumptions which guided the D'Antonio court and which are urged here by appellant. Cavness, supra. These assumptions hold that there must be a presumption of prejudice where there has been any outside contact. They are a part of a tradition which formerly required jurors not only to be isolated, but to fast until a verdict was reached. Stone v. United States, 113 F. 2d 70 (6th Cir. 1940). Only where there has been a compromise of the jury's independence should there be concern. It is to be hoped that the trend away from such attitudes will continue.

The trend that we suggest has been adopted by many federal courts, including several which flatly contract appellant's main case. In Carter v. United States, 252 F. 2d 608 (D. C. Cir. 1958) it was expressly held that separation is permissible as long as the court takes appropriate precaution to see there is no undue influence exerted during the separation. In Wheeler v. United States, 165 F. 2d 225 (D. C. Cir. 1947), cert. denied 333 U. S. 829 (1948), it was held to be within the court's discretion to permit separation and not reviewable unless actual prejudice was shown.

The case of Hines v. United States, 365 F. 2d 649 (10th Cir. 1966), exactly adopts this position, and contradicts the D'Antonio case. As here, the jury was allowed to go home for the night

after deliberations had begun, and this was urged on the Court of Appeals as error. In response, it was held that the trial court has the full discretion to allow the jury to separate, in the absence of a showing of actual prejudice or circumstances from which prejudice might arise. The jury must of course be protected by the court by keeping it under varying degrees of seclusion. Presumably, the appropriate degree of seclusion depends on the circumstances surrounding the case.

The government does not hesitate to concede that in a trial of a notorious crime, in which there is widespread community concern due to press coverage, or where a particular person or group may feel that its interests require a particular result at any cost, that seclusion of the jury may be required in the interest of justice. We assume that such circumstances are what the Tenth Circuit had in mind by "circumstances from which prejudice may arise".

There are of course thousands of felony jury trials each year. To require that in each of these trials, whatever the outside circumstances, jurors must be closeted as public expense each night until a verdict is reached would place an onerous burden on the public treasury and the convenience of all concerned.

In this case, counsel at no time has suggested that the jury was in fact importuned, or that publicity or other factors created a climate in which improper pressures on the jury were likely. Therefore, the best view of appellant's arguments is that they are merely technical, and should not be the basis of reversal

where guilt was otherwise satisfactorily demonstrated.

The court may be concerned with certain problems which the Hines case may be thought to create, if a jury is allowed to go home for the evening, and there is no obligation (there was none in this case) that prejudicial communications were offered to jurors. The New York Court of Appeals has dealt with this problem in the case of People v. Genovese, 10 N.Y.2d 461 (1962). There, articles appeared in local newspapers alleging that the defendant was a person of low repute and a gangster. It was determined that the effect of such communications could be adequately ascertained on motion for a mistrial by the court polling each juror, and asking him if the articles had in any way affected his ability to decide the case on the sole basis of the evidence in court. Consistent with the sound policy of respect for the integrity of jurors announced by this Court in Cavness, supra, the New York Court felt that the solemn word of jurors in answer to such questions should be accepted.

Finally, appellant urges that his failure to raise issues of the possible impropriety of sending the jury home or to allege actual or presumptive prejudice below does not foreclose him from arguing them before this Court de novo. We assert that waiver may be implied by silence in this case. Counsel was not faced with an issue of impossible complexity, but one of common sense. If there was a danger of prejudice, reasonably competent counsel can be expected to have recognized same, and brought it to the trial court's attention. It is the trial court which is directly in

contact with the factual circumstances of the case, and that court should have been presented the opportunity to consider the issue, if indeed there was one. There has been no known case on this particular, narrow point. However, an analogy can be made to cases in other areas involving waiver by silence.

These cases express a concern for the rights of criminal defendants, which may be lost because of the defendant's ignorance of law. The solution found by the courts has been to insure that such a person has the aid of a lawyer at every stage of the case, including interrogation. Miranda v. Arizona, 348 U.S. 436 (1966). Once assisted by counsel, waiver may be made. These considerations do not apply to situations involving the conduct and strategy of lawyers in open court, for they presumably know the law and are immune from being overborne into throwing their rights away.

As we have made clear, however, whether there was a waiver or not is immaterial to the result, for appellant's contentions are not sufficiently compelling to warrant a reversal and retrial, with all the expense and inconvenience that implies.

C. NO PART OF THE SO-CALLED ALLEN INSTRUCTION IS SLANTED IN FAVOR OF THE PROSECUTION, AND UNDER NO THEORY IS FAILURE TO RECITE THE WHOLE OF SAID INSTRUCTION PREJUDICIAL TO THE DEFENDANT.

If the appellants other contentions are insubstantial, his arguments surrounding the so-called "Allen Instruction" (taken

from Mathes & Devitt §15.16) are utterly frivolous. Rather than consume the court's time with unnecessary pages of legal prose, we adopt the expedient of incorporating the entire part of the instruction which the court did read to the jury. It will become clear that contrary to appellant's veiled suggestion, the first part is not slanted toward the government, and the omitted portions are not needed to balance it; indeed for the most part they merely restate what was said before. The court had previously fully informed the jury of the presumption of innocence [C. T. 842, 843, 846, 854].

[R. T. 879] "§15.16 Supplemental Instruction - When Jurors Fail to Agree Seasonably

"The Court wishes to suggest a few thoughts which you may desire to consider in your deliberations, along with the evidence in the case, and all the instructions previously given.

"This is an important case. The trial has been expensive in time, and effort, and money, to both the defense and the prosecution. If you should fail to agree on a verdict, the case is left open and undecided. Like all cases, it must be disposed of sometime. There appears no reason to believe that another trial would not be costly to both sides. Nor does there appear any reason to believe that the case can be tried again, by either side, better or more exhaustively than it has been tried before

you. Any future jury must be selected in the same manner and from the same source as you have been chosen. So, there appears no reason to believe that the case would ever be submitted to twelve men and women more conscientious, more impartial, or more competent to decide it, or that more or clearer evidence could be produced on behalf of either side.

"Of course these things suggest themselves, upon brief reflection, to all of us who have sat through this trial. The only reason they are mentioned now is because some of them may have escaped your attention, which must have been fully occupied up to this time in reviewing the evidence in the case. They are matters which, along with other and perhaps more obvious ones, remind us how desirable it is that you unanimously agree upon a verdict.

"As stated in the instructions given at the time the case was submitted to you for decision, you should not surrender your honest convictions as to the weight or effect of evidence, solely because of the opinion of other jurors, or for the mere purpose of returning a verdict.

"However, it is your duty as jurors to consult with one another, and to deliberate with a

view to reaching an agreement, if you can do so without violence to individual judgment. Each of you must decide the case for yourself, but you should do so only after a consideration of the evidence in the case with your fellow jurors. And in the course of your deliberations, you should not hesitate to reexamine your own views, and change your opinion, if convinced it is erroneous.

"In order to bring twelve minds to an unanimous result, your must examine the questions submitted to you with candor and frankness, and with proper deference to and regard for the opinions of each other. That is to say, in conferring together, each of you should pay due attention and respect to the views of the others, and listen to each other's arguments with a disposition to reexamine your own views.

"If much the greater number of you are for a conviction, each dissenting juror ought to consider whether a doubt in his or her own mind is a reasonable one, since it makes no effective impression upon the minds of so many equally honest, equally conscientious fellow jurors, who bear the same responsibility, serve under the same oath, and have heard the same evidence with, we may assume, the same attention and an equal desire

to arrive at the truth. On the other hand, if a majority or even a lesser number of you are for acquittal, other jurors ought seriously to ask themselves again, and most thoughtfully, whether they do not have reason to doubt the correctness of a judgment, which is not concurred in by many of their fellow jurors, and whether they should not distrust the weight and sufficiency of evidence, which fails to convince the minds of several of their fellows to a moral certainty and beyond a reasonable doubt.

"You are not partisans. You are judges -- judges of the facts. Your sole interest here is to ascertain the truth from the evidence in the case. You are the exclusive judges of the credibility of all the witnesses, and of the weight and effect of all the evidence. In the performance of this high duty, you are at liberty disregard all comments of both court and counsel, including of course the remarks I am now making.

"Remember, at all times, that no juror is expected to yield a conscientious conviction he or she may have as to the weight or effect of evidence. But remember also that, after full deliberation and consideration of all the evidence in the case, it is your duty to agree upon a verdict, if you can do so without

violating your individual judgment and your conscience."

Supplemental instructions of the kind and tenor as given in the instant case have by long standing practice been approved since the decision of the United States Supreme Court in Allen v. United States, 164 U.S. 492 (1896). The use of various permutations of this instruction has been attacked on the theory that such an instruction coerced dissenting jurors to compromise their views for the sake of agreement. However, as we point out the words used by Judge Curtis reminded the jury of their duty to dissent if in their best judgment it was appropriate.

A holding which flatly disapproves of the Allen Instruction would result in a greater number of cases having to be retried as a result of jurors' reluctance to reach a decision in complicated cases. This would create a climate which is inconducive to the cause of speedy, efficient justice. Furthermore, such a holding would be unfair to defendants, in that many are ill prepared to bear the expense of a second trial. The government, on the other hand, can well afford any number of trials.

The attacks on the Allen instruction have been specifically repudiated by the Ninth Circuit in the following cases: Henry v. United States, 361 F.2d 352 (9th Cir. 1966); Christy v. United States, 261 F.2d 357 (9th Cir. 1958), cert. denied 360 U.S. 919, reh'g. denied 361 U.S. 857; Hutson v. United States, 238 F.2d 167 (9th Cir. 1956); United States v. Kawikata, 190 F.2d 506 (9th Cir. 1951), aff'd 343 U.S. 717.

The appellant cites the case of Berger v. United States, 62 F.2d 438 (10th Cir. 1938) for the proposition that readmonition as to the presumption of innocence is necessary to balance the possible "coercive" effects of a supplemental charge. Appellant fails to be candid with this Court in not disclosing that what was required to be balanced there was not the same as that suggested in this case. In Berger the court first wrongfully asked the jury how it was divided. Then, in an air of coercion against the dissenters, gave the following charge: "This is a very important case. The evidence is very simple and very clear, and there is not much of it. The government is at much expense in this case, spending all this time bringing all these witnesses." 62 F.2d at 438.

It is easy to see how such a statement would have to be balanced by a strong reminder of the presumption of innocence, for it amounts to almost an order to the dissenters to convict. Taking these facts into account, it cannot be said that the case stands for the proposition that supplemental charges are inherently coercive, as appellant suggests.

Finally, we would note that in United States v. Allis, 73 Fed. 167 (Circuit Court E.D. Kan. 1893), which appellant cites as an example of a charge which properly safeguarded the rights of a defendant, the charge given was in substance identical to that given by Judge Curtis here. It did NOT contain the language omitted, or anything resembling it.

D. THERE WAS AMPLE EVIDENCE OF REQUISITE INTENT TO AVOID PAYMENT OF TAX AND THE JURY WAS FULLY JUSTIFIED IN FINDING GUILT.

The government is in full agreement with appellant in his application of Holland v. United States, 348 U.S. 121 (1954) that in addition to non-payment of tax, the final element of wilfulness to evade tax must be shown, which cannot be inferred from a mere understatement of income.

We are in further agreement that wilfullness involves a specific intent which must be proved by independent evidence, that wilfullness involves a state of mind, and that direct proof of wilfullness is seldom available. Since it is to be assumed that Congress did not enact self-defeating legislation, the question then becomes what kind of independent evidence may be used to show the requisite state of mind.

Appellant has correctly stated that a consistent pattern of under-reporting of income or over-claiming deductions, and not recording such items on the taxpayer's records is evidence from which wilfullness may be inferred. Blackwell v. United States, 244 F.2d 423, 429 (8th Cir. 1957). This meshes perfectly with the failure to keep records of the mostly cash transactions here. Wilfull intent may be inferred from the acts of the parties and such inference may arise from a combination of acts although each act standing by itself may seem unimportant. It is a question of fact to be determined from all the circumstances. Battjes v. United

States, 172 F. 2d 1, 5 (6th Cir. 1949). Affirmative, wilfull attempt may be inferred from . . . any conduct, the likely effect of which would be to mislead or conceal. The failure by experienced businessmen to demand notes or keep records of "loans" even if personal can only be explained in this way.

It may have been of no consequence for the purposes of §7201 that appellant received a single sum of money from one individual as a "loan" or "gift" and did not pay it back. Even a series of such transactions over time with one individual may be of dubious import for purposes of the section. However, a series of transactions involving thousands of dollars paid to appellant by several people with whom appellant was acquainted in a commercial, business context and with whom appellant had carried on business transactions has no other explanation than that the money was paid for services rendered. This was indeed a general pattern of conduct by appellant from which the jury could infer the requisite intent. Remmer v. United States, 205 F. 2d 277, 288 (9th Cir. 1953). Of course the question before this Court is whether a jury could infer the requisite intent; the weighing of evidence and making of findings is the job of the jury.

"Wilfully" means more than intentionally or voluntarily in the sense that in addition to knowing one is not paying tax on certain monies one must know that a tax is properly due. If one thinks a tax is not due, under however erroneous a notion of the law, §7201 has not been violated.

Appellant, who appears highly intelligent and knowledgeable

in business can hardly claim that he did not know there is no obligation to pay income tax on money received for services rendered in a business transaction. Not having been excluded by Congress, kickbacks are income. It is immaterial that the payors of kickbacks sought to conceal the fact that they were engaged in such conduct by characterizing the payments as loans or gifts in fear of the sanctions of the Packers and Stockyards Act, 7 U.S.C. §181 ff (1964). Only the intent of the taxpayer is at issue.

Once a pattern of payments has been established it is clearly a question for the jury whether there was a wilfull attempt to evade tax due thereon. This is so despite the possibility of a bona fide misconception of law. Wardlaw v. United States, 203 F.2d 884 (5th Cir. 1953), cited by appellant, specifically so held. None of appellant's other cases disturb this conclusion.

In Holland v. United States, 348 U.S. 121 (1964), there was a prosecution for evasion of tax based on unexplained increases in net worth of the taxpayer. The government introduced evidence of a likely taxable source of these increases, as it did here. It was held that the fact that the government did not negative the possibility that the money came from non-taxable sources was not fatal to conviction. The analogy to the facts of this case is simple and clear. It is up to the government to show a clear possibility of taxable payments, and up to the jury to determine if the possibility is a reality. The fact that appellant was unable to make his own case by negating taxability reinforces the inference of guilt. That he was acquitted on the first two counts of the indictment

shows that the jury did in fact give him the benefit of every possible doubt, refusing to convict him for years in which his pattern of behavior had not become firmly entrenched.

Finally, we would note that since the gist of the offense in §7201 is attempt to evade tax, it is not necessary for the government to show the exact amount of the tax due, or success in actually evading the tax. United States v. Norris, 205 F. 2d 828 (2nd Cir. 1953). Therefore, if in any year all but one of the payments received by appellant was in fact a loan, but the one remaining payment was income, conviction could be had. This affords the widest range of safety to the government's case, as the jury would be justified in convicting even if it disbelieved most of the government's evidence.

The government was able to paint an elaborate picture of a string of kickbacks paid to appellant, who had a reputation for taking more such payments than anyone in the industry. He introduced no substantial evidence to the contrary but confined himself to making weak attacks on the soundness of the prosecution's case and witnesses. Appellant's strong desire to be free of the burden of his conviction is understandable. However, he has put forward nothing that would warrant a court of law to grant the relief sought. The evidence was sufficient to sustain a conviction.

CONCLUSION

Based on the facts presented, the court below was fully justified in convicting the appellant. The procedural points raised by appellant are insubstantial and at times approach the frivolous. Therefore, the District Court's judgment must be affirmed.

Respectfully submitted,

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Attorneys for Appellee,
United States of America.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Jo Ann Dunne
JO ANN DUNNE

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[illegible]

[illegible]

[illegible]

NO. 22194

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

SEQUOIA MACHINERY, INC., a Corporation,
and KAWEAH COMPANY, a Corporation,

Appellants,

vs.

J. RODERICK JARRETT, Trustee of the
Estate of JAMES C. CLARK, Bankrupt,

Appellee.

BRIEF FOR APPELLANTS

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

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BRIEF FOR APPELLANTS

JURISDICTIONAL STATEMENT

This is an appeal from a Final Order dated January 30, 1967, of the United States District Court, Eastern District of California, affirming the Order of the Referee in Bankruptcy, dated April 12, 1967, in the Matter of James C. Clark, Bankrupt, No. 20557 ND, in Bankruptcy, holding the security interests of appellants in certain grain harvesting combines sold to the Bankrupt to be invalid as against the Trustee in Bankruptcy. The controversy arose in the Bankruptcy Court upon the Trustee's Petition for an Order to Show Cause directed to appellants to show the nature,

extent and validity of their alleged liens and for a turn-over Order for monies derived from the sale of the property after repossession by appellants in exercise of their alleged security rights, and upon the Order to Show Cause issued upon such petition. On April 19, 1967, appellants made timely filing of a Petition for Review of the Referee's Order to the District Court. On June 30, 1967, the United States District Court, M. D. Crocker, United States District Judge, presiding, made and entered its Order affirming the Referee's Order of April 12, 1967, and appellants made timely filing of Notice of Appeal from said Order on July 19, 1967. The jurisdiction of both the District Court and of the United States Circuit Court of Appeals for the Ninth Circuit rests upon the right of appellants to appeal a final Order made in a "controversy arising in proceedings in bankruptcy" under the provisions of Section 24 of the United States Bankruptcy Act; United States Code, Title 11, Chapter 4, Section 47. The amount in controversy exceeds $500.00, and therefore, leave to appeal under Section 24 (a) of the Bankruptcy Act, 11 U.S.C.A., Section 47 is not required.

STATEMENT OF THE CASE

This is a controversy arising in a proceeding in Bankruptcy in which the trustee in bankruptcy claims that the security interests of the appellants in certain grain harvesting combines which had been sold by appellants to the bankrupt are invalid. The claim of invalidity is based upon the Trustee's contention that California

Commercial Code, Section 9401 (1)(a) required appellants to file financing statements in the office of the County Recorder of Tulare County, which was the county of the bankrupt's residence. The appellants contend that the financing statements were properly filed with the Secretary of State of the State of California. On July 19, 1966, following the filing of the petition in bankruptcy and the bankrupt's adjudication, appellants repossessed the grain harvesting equipment which they had sold to the bankrupt, and on August 5, 1966, a sale was held from which appellants realized the sum of $30,200.00 for the equipment in which the security interests are now in controversy. On January 9, 1967, the Trustee filed his Petition for an Order to Show Cause to determine the nature, extent and validity of the appellants' security interests in said grain harvesting equipment and for a turn-over Order as to the money received upon such resale. An Order to Show Cause was issued upon the Trustee's Petition by the Referee in Bankruptcy and a hearing was held on January 17, 1967. There is no controversy as to the facts of the case. The parties entered into a Stipulation as to the facts on February 3, 1967, which stipulates that the facts of the case are as follows:

1. That James C. Clark is the bankrupt in the above-entitled proceedings in bankruptcy in this Court and was adjudicated a bankrupt on a voluntary petition filed herein on July 5, 1966.

2. That petitioner, J. Roderick Jarrett, is the duly appointed, qualified and acting Trustee of said bankruptcy estate.

3. That the bankrupt purchased the items of equipment

particularly described in Exhibit "A" attached hereto on conditional sale contracts as described in Exhibit "A", copies of which contracts are respondent's Exhibit I through VIII inclusive, said purchases being made by the bankrupt on the dates of the various contracts and for the purchase prices indicated on each of those contracts.

4. That the bankrupt was during the period from the date of the first contract until just prior to the filing of the bankruptcy petition engaged in the business of "custom harvesting". "Custom harvesting" is the common name used in the trade to designate the business of the bankrupt which is generally described as follows: The bankrupt owned the equipment (designated in Exhibit "A" and subject to the security interests of respondents) consisting of a gas dryer, a number of combines and a corn attachment. The bankrupt would enter into contracts with grain farmers for the harvesting of their grain crops. The bankrupt would agree to harvest barley, corn and milo for so many dollars per acre plus so many dollars per pound of grain in excess of one thousand pounds per acre or similar arrangements. The combines are self-powered, self-contained harvesting units which cut and thrash the grain and send the thrashed grain into a bulk tank on the combine from which it is removed into a bulk truck or other bulk tank on the ranch or elsewhere. The corn attachment unit is to attach to a combine for the purpose of converting its use from the harvesting of barley to the harvesting of sweet corn. The bankrupt would harvest the farmer's grain on a contract similar to that described

above and either leave the grain on the farm or transport it to a mill or other farm depending on his arrangement with the farmer.

5. During the period in question the bankrupt did not plant or raise any crops of any kind, nor did the bankrupt own or lease any land upon which agricultural crops or livestock were raised or grown. The bankrupt did not till the soil. The bankrupt was not a farmer. The bankrupt was a custom harvester and contracted with approximately 8 or 10 or more farmers per season for the harvesting of grain crops on the general terms outlined above. Most of these contracts were entered into in connection with grain crops in Tulare County, but some custom harvesting was done in Kings County.

6. The combine units are specialized equipment which can be used for the sole purpose of harvesting grain. A substantial portion of the grain harvesting in the San Joaquin Valley is done by custom harvesters doing business in a similar manner as the bankrupt did business as above described.

7. The bankrupt, in connection with his custom harvesting business employed various numbers of employees and during the last harvesting season, as many as 18 employees. All of the equipment specified on Exhibit "A", except the gas dryer, was used by the bankrupt in his custom harvesting operation and used by no person other than the bankrupt for no other purpose.

8. The gas dryer is a piece of equipment ordinarily used in a stationary position to dry grain which is transported to and from the dryer by the operator of the gas dryer, or the farmer.

The primary use of gas dryers is at mills and at gins. The bankrupt's gas dryer was located at his home and he contracted for gas drying on approximately the same type of arrangement as the custom harvesting arrangement. The gas drying is a business separate from the harvesting business.

9. That the fair-market value at the time of bankruptcy herein of each item of equipment described in Exhibit "A" is the sale price designated thereon.

Exhibit "A" is as follows:

Item	CSC Date	Sale Price	Filed	Place Filed
John Deere D-3096 with attachment #946	8/14/65	$2,600.00	FS	Sacramento
John Deere D-2559 55 Combine #63614	4/16/62	$1,800.00	CS	Sacramento
John Deere D-2603 105 Combine #1294	5/13/62	$6,000.00	CS	Sacramento
John Deere D-2683 Gas Dryer #304	10/9/62	$3,000.00	CS	Sacramento
John Deere D-2794 105 Combine #1894	5/14/63	$6,000.00	CS	Sacramento
John Deere D-2964 105 Combine #3187	6/4/64	$7,000.00	CS	Sacramento
John Deere D-2981 410 with corn attachment #480	9/3/64	$1,800.00	CS	Sacramento
John Deere D-2617 105 Combine #1296	7/9/62	$5,000.00	CS	Sacramento

CSC - Conditional Sale Contract
CS - Continuation Statement
FS - Financing Statement

The Trustee held that the financing statement covering the John Deere 550 Gas Dryer #304 was properly filed with the Secretary of State, and this appeal does not concern that item of equipment. The sole question in this case is whether Section 9401 (1)(a) of the California Commercial Code required appellants to file financing statements to perfect their security interests with the County Recorder of the county of the bankrupt's residence or whether Section 9401 (1)(c) of the Code required filing with the Secretary of State of California.

SPECIFICATION OF ERRORS RELIED UPON

1. The District Court erred in affirming the Order of the Referee in Bankruptcy, dated April 12, 1967, holding appellants' security interests invalid and granting to the Trustee in Bankruptcy a turn-over Order.

2. The District Court erred in holding that respondents were required by Section 9401 (1)(a) of the California Commercial Code to file their financing statements in the office of the County Recorder of Tulare County.

SUMMARY OF ARGUMENT

This controversy presents a question of statutory construction. Section 9401 of the California Commercial Code at subsection (1)(c) provides for filing of financing statements to perfect security interests with the office of the Secretary of State in all cases other than those specifically excepted in the preceding subsections (a) and (b) of Section 9401 (1). Appellants contend that the general rule requiring central filing with the Secretary of State applied in this case as to the financing statements covering the security interests of appellants in the commercial harvesting equipment of the bankrupt. Appellants contend that the exception contained in California Commercial Code Section 9401 (1)(a) requiring local filing of financing statements concerning "equipment used in farming operations" did not apply. Appellants submit that the words "farming operations" as used in Section 9401 (1)(a) mean the same as "farming ventures" and refer to the business or operation which is conducted by a farmer, because California Commercial Code Section 9109 (3) in enumerating specific classes of farming operations, refers only to "raising, fattening, grazing or other farming operations". Appellants argue, therefore, that equipment must be used by a debtor who is engaged in a farming operation in the sense of operating a farm in order to come within the exception of Section 9401 (1)(a) requiring local filing. The bankrupt in this case, admittedly was not a farmer, but, instead, was engaged in a commercial harvesting operation in more than one county. The

exception requiring local filing applies to essentially local transactions. Transactions by farmers are essentially local, because related to a farm. A transaction involving one who is not engaged in farming, even though he may be engaged in a business dealing with farmers, is not essentially local, and therefore, should not come within the local filing exception to be consistent with the intent and purpose of the entire Code.

ARGUMENT

I

UNDER THE UNIFORM COMMERCIAL CODE, CENTRAL FILING WITH THE SECRETARY OF STATE IS THE RULE AND LOCAL COUNTY FILING IS THE EXCEPTION. WHEN THE EXCEPTION IS MADE, IT IS ONLY FOR "ESSENTIALLY LOCAL" TRANSACTIONS.

Section 9401 of the Uniform Commercial Code (ULA) sets forth in optional paragraph (1)(a) of the 2nd and 3rd alternatives the provision for local filing adopted by California. This is subparagraph (a) of California Commercial Code Section 9401 (1) which provides as follows:

(1) The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is equipment used in farming operations, or farm products other than crops, or accounts or contract rights arising from or relating to the sale of farm products by a farmer, or

consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this State, then in the office of the county recorder in the county where the goods are kept;

(b) When the collateral is crops or timber to be cut, then in the office of the county recorder in the county where the land on which the crops are growing or to be grown or on which the timber is standing is located;

(c) In all other cases, in the office of the Secretary of State.

(2) . . . .

In the Uniform Code comment, page 546, et seq. of West's Annotated Code, the Code Commissioners discuss the two systems of filing, local and state-wide, and the general preference for the state-wide system, saying at comment number 4, page 547 of the West's Annotated Code:

> It is thought that sound policy requires a state-wide filing system for all transactions except the essentially local ones covered in subsection (1)(a) of the Second and Third Alternatives and transactions involving fixtures covered in subsection (1)(b) of the Second and Third Alternatives.

And on page 546 in commenting on the two systems, the commissioners say:

> The more completely the files are centralized on a state-wide basis, the easier and cheaper it becomes to procure credit information; the more the files are scattered in local filing units, the more burdensome and costly. On the other hand, it can be said that most credit inquiries about local businesses, farmers and consumers come from local sources; convenience is served by having the files locally available and there is no great advantage in centralized filing.

It should be emphasized that the code commissioners said in their comment number 4 that the state-wide filing system is required by sound policy, except for "essentially local" transactions. A "farming operation" in the meaning of a farming venture or the business of a farmer, would be an essentially local business, because essentially related to the land. On the other hand, a transaction involving a commercial hauler of farm products, a commercial crop duster, or a commercial harvester who does work for many farmers would not be essentially local. Commercial Code Section 9401 (1)(a) does not say "farm equipment", but instead says "equipment used in farming operations". The reason for this must be that the same equipment may be farm equipment when used by a farmer in his farming operation and industrial equipment when used by a debtor who is not a farmer. The balance of subsection (a) of Section 9401 (1) in referring to farm products and the sale of

farm products when it inserts the words "by a farmer" further bears out and supports that what is contemplated for local filing is transactions involving a farmer and that "equipment used in farming operations" could be paraphrased "equipment used by farmers".

II

THE CODE RECOGNIZES COMMERCIAL HARVESTING EQUIPMENT AS BEING NOT ESSENTIALLY LOCAL.

Further on the point of whether transactions involving commercial harvesters such as those of the bankrupt are of "essentially local" character requiring local filing is Section 9103 of the California Commercial Code which discusses conflict of law rules where collateral may have contact with more than one jurisdiction. This statute says in part, "With regard to goods of a type which are normally used in more than one jurisdiction (such as automative equipment, rolling stock, airplanes, road building equipment, commercial harvesting equipment, construction machinery and the like . . .". It is interesting to note that commercial harvesting equipment is included among these itemized classes of equipment as an example of goods which are definitely not essentially local. It is a stipulated fact in our case that the bankrupt in his commercial harvesting business used his harvesters on contract jobs for many farmers and in more than one county. It is recognized that Section 9103 of the Commercial Code is referring to the jurisdiction of different states and not different counties, but the

point is that commercial harvesters are put in a class with commercial heavy equipment which has a relatively high likelihood of being moved from one jurisdiction to another and all of which is obviously of a type which would require central filing if involved in security transactions under the code.

III

WHILE THE COMMERCIAL CODE DOES NOT DIRECTLY DEFINE "FARMING OPERATIONS", THE CODE ENUMERATION OF THE SPECIFIC THINGS INCLUDED IN "FARMING OPERATIONS" PRECLUDES THE INCLUSION OF A BUSINESS OPERATION EVEN THOUGH RELATED TO AGRICULTURE WHICH DOES NOT INVOLVE THE PRODUCTION OF AGRICULTURE PRODUCTS.

California Commercial Code Section 9109 defines the classes of goods and provides at subdivision (2) that they are:

> (2) "Equipment" if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods.

And at Subdivision (3) that they are:

> (3) "Farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or

> livestock in their manufactures states (such as ginned cotton, wool clip, maple syrup, honey, milk and eggs), and if they are in the possession of a <u>debtor engaged in raising, fattening, grazing or other farming operations.</u> If goods are farm products they are neither equipment, nor inventory. (Emphasis added)

As stated above, the words "farming operations" are not directly defined by the code; however, in the above quoted subdivision (3) of Section 9109, the words "debtor engaged in raising, fattening, grazing or other farming operations" gives an indication of the meaning of "farming operations". The specific examples of farming operations there enumerated, involve the production of crops or other agricultural commodities. It would seem that the maxim of "<u>expressio unius est exclusio alterius</u>" would preclude the inclusion in the meaning of "farming operation" of a business operation albeit related to agriculture which does not involve the production of agricultural products. See 45 Cal. Jur. 2d Statutes, Section 133, pages 639-640. Further on this point, is the uniform code comment number 4 to Section 9109 which says in part at page 371, West's California Commercial Code Annotated:

> The terms, "crops" "livestock" and "farming operations" are not defined; however, it is obvious from the test that "farming operations" includes raising livestock as well as crops; similarly, since eggs are products of livestock, livestock includes fowl.

IV

THE TENOR OF THE CODE CONSISTENT WITH THE ESSENTIALLY LOCAL TRANSACTIONS EXCEPTION IS THAT GOODS MUST BE IN THE POSSESSION OF A FARMER OR THE TRANSACTIONS MUST BE BY A FARMER TO QUALIFY FOR LOCAL FILING.

When Commercial Code Sections 9401 (1)(a) with its language "relating to the sale of farm products by a farmer", and Commercial Code Section 9109 (3) with its words "and if they are in possession of a debtor engaged in raising, fattening, grazing or other farming operations" are compared, it becomes rather clear that "debtor engaged in farming operations" and "farmer", are, within the meaning of the code, the same. It has been stipulated in this case that the bankrupt was not a farmer, did not plant or raise crops of any kind and did not own or lease any land upon which agricultural crops or livestock were raised or grown.

The Trustee has argued that it is solely the use to which the equipment is put which is determinative and not the person who holds the equipment. In comment number 2 of the Uniform Commercial Code comment Section 9109 at page 370 of West's California Commercial Code Annotated, it is stated:

> The classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory, for example.

The use of the words "and as to the same person" in this comment,

contradicts the Trustee's argument. Thus, a caterpillar tractor used by a farmer to level his land or to build field roads would be farm equipment and would require local filing, but a caterpillar tractor used by a land leveler or a road construction outfit would be commercial equipment and would require central filing. Further, one would not describe a commercial harvester as being "engaged in a farming operation" anymore than one would so describe a commercial trucker whose sole business is hauling crops to market, or a commercial land leveler whose sole business is leveling farm land, so that it can be planted to crops, or a farm supply retailer which has spray rigs and does commercial spray work. These businesses are auxiliary to the business of a farmer, but are not businesses in which we would say the proprietors are engaged in a farming operation. Appellants contend that in determining the place of filing of financing statement, reference must be made to the person and not to the equipment in order to make a determination. One engaged in the financing business who must determine where to file financing statements, would, in interviewing the debtor, ask the business the debtor was engaged in, in determining where to file. It would be impractical for the lender to have to make a determination as to various types of equipment as to whether they should be in any specific instance, called farm equipment or not farm equipment, since there are many types of equipment that may be farm equipment only when used by a farmer.

V

THE COMMERCIAL CODE ANNOUNCES A POLICY OF LIBERAL CONSTRUCTION AND A POLICY OF UPHOLDING THE VALIDITY OF SECURITY AGREEMENTS.

California Commercial Code Section 1102 calls for a liberal construction of the code to promote its underlying purposes and policies and these are set forth. Section 9201 of the California Commercial Code says that a security agreement is effective between the parties and against creditors, except as otherwise provided in the code. These sections announcing the policy of the code and the general validity of security agreements require a construction wherever possible which upholds the validity of security agreements and commercial transactions. Under the general rules of construction a fair and reasonable meaning should be given to a statute to give effect to its apparent object and purpose and to promote justice. See 45 Cal. Jur. 2d, Statutes, Section 180, page 680. The consequences which may arise from a particular interpretation of a statute may be considered unless the language is clear and explicit so that a statute should normally be interpreted in a way which will make it reasonable and fair. See 25 Cal. Jur. 2d, Statutes, Section 122, page 631.

45 Cal. Jur. 2d, Statutes, Section 186, pages 684-685 discusses statutes providing for forfeitures or penalties and states that since forfeitures or penalties are not favored, a statute which would impose a forfeiture or penalty must be strictly construed and

as favorably to the person whose property is to be seized or forfeited as is consistent with principles of fair interpretation. The only argument from this is that in this case, we are talking about taking many thousands of dollars from a businessman who filed a financing statement which was in all respects regular as part of a commercial transaction, which in all respects complied with the law upon the sole argument that the financing statement should have been filed locally, instead of with the Secretary of State. The interpretation of the statute which would uphold the security interest and prevent a forfeiture would appear to be a fair one and the one contemplated by the Commercial Code.

CONCLUSION

The words "used in farming operation" are not clear in their meaning unless the entire commercial code and the purpose of the code is examined. The purpose and policy of the commercial code as evidenced by other code sections, and as shown by the Code Commissioners comments is to prefer central filing with the Secretary of State and to make local filing the exception. The language of the other code sections indicates that a farming operation is one which is engaged in by a farmer who produces agricultural products. It is an entire operation of production and is not one isolated phase performed by one who is not a farmer. Commercial businesses which relate to some isolated phase of the entire farming operation and are not engaged in by farmers do not meet

the test of essentially local transactions. The Commerical Code specifically recognizes commercial harvesters as not being essentially local. Therefore, upon an examination of all of the provisions of the Commercial Code and the code commissioners' comments, it becomes clear that the commercial harvesters were not equipment used in farming operations and that the security interest should be upheld. The case for validity of the security interests of the respondents is further bolstered by the general rules of statutory construction which require fairness and liberality and discourage forfeitures and also, by the general provisions of the Commercial Code announcing the policy favoring the validity of security interests and simplifying and encouraging commercial practices.

Respectfully submitted,

ROBERT P. STRINGHAM

Attorney for Appellants

February, 1968.

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 22194

SEQUOIA MACHINERY, INC., A CORPORATION, AND KAWEAH COMPANY, A CORPORATION, APPELLANTS,

VS.

J. RODERICK JARRETT, TRUSTEE OF THE ESTATE OF JAMES C. CLARK, BANKRUPT, APPELLEE.

STATEMENT REQUIRED BY RULE 18-2 (g) OF THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

I CERTIFY THAT IN CONNECTION WITH THE PREPARATION OF THIS BRIEF, I HAVE EXAMINED RULES 18, 19 AND 39 OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT, AND THAT, IN MY OPINION, THE FOREGOING BRIEF IS IN FULL COMPLIANCE WITH THOSE RULES.

Robert P. Stringham

ROBERT P. STRINGHAM
ATTORNEY FOR APPELLANTS

No. 22194

In the

United States Court of Appeals

For the Ninth Circuit

SEQUOIA MACHINERY, INC., a corporation, and KAWEAH COMPANY, a corporation, *Appellants,*	
vs.	
J. RODERICK JARRETT, Trustee of the Estate of James C. Clark, Bankrupt, *Appellee.*	

Appellee's Brief

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In the

United States Court of Appeals

For the Ninth Circuit

Sequoia Machinery, Inc., a corporation, and Kaweah Company, a corporation,
Appellants,

vs.

J. Roderick Jarrett, Trustee of the Estate of James C. Clark, Bankrupt,
Appellee.

Appellee's Brief

I

JURISDICTIONAL STATEMENT

Notice of appeal was filed with the District Court on July 19, 1967 (T.R. 55)*, from the Order of the District Court entered on June 30, 1967 (T.R. 53).

The United States Court of Appeals for the Ninth Circuit is vested with jurisdiction of this appeal from the United States District Court for the Eastern District of California

*Citations to the Record on Appeal throughout Appellee's Brief are in the above form, which indicates page in the (Clerk's) transcript of record. There is no reporter's transcript.

by Judicial Code Sections 1291 and 1294(1), 28 U.S.C. Section 1291 and 1294(1), and Bankruptcy Act Sections 24a and 25a, 11 U.S.C. Sections 47a and 48a.

II

STATEMENT OF THE CASE

James C. Clark, the bankrupt in the proceedings in which this controversy arose, was adjudicated bankrupt on a voluntary petition filed in the Eastern District of California, at Fresno, on July 5, 1966 (at that time the Southern District of California, Northern Division).

At that time the bankrupt had possession of certain equipment including the grain harvesters involved in this proceeding. On July 19, 1966, while the harvesters were in the constructive possession of the bankruptcy court, appellants repossessed the harvesters and sold them on August 5, 1966, without reclamation or other formal proceedings.

The trustee thereafter initiated these proceedings requesting the turnover to the trustee of the fair value of the harvesters. Appellants contended that they had a perfected security interest in the equipment and were therefore not accountable to the estate.

Appellants based the claimed perfection of their security interests upon the filing of financing or continuation statements in the office of the Secretary of State of California. No statements were filed in the county of the debtor's residence as required by California Commercial Code Section 9401(1) in order to perfect a security interest in "equipment used in farming operations." Although the equipment involved consisted of grain harvesters manufactured and used exclusively for the harvesting of grain, it is appellants' argument that these harvesters were not "equipment used in farming operations."

The referee concluded that the harvesters were "equipment used in farming operations" (Conclusion of Law No. 2, T.R. 33), and the Judgment (T.R. 37) was entered ordering appellants to turn over to the estate the sum of $30,200.00, the agreed fair value of the equipment.

This judgment was affirmed by order of the District Court filed April 12, 1967 (T.R. 53).

The sole question before the court is whether the grain harvesters involved were "equipment used in farming operations" within the meaning of that phrase as used in Section 9401(1)(a) of the California Commercial Code.[1] This question revolves upon whether the inclusion of "equipment" in the class "equipment used in farming operations" depends upon the "use" of the equipment or upon the occupational or contractual status of its owner.

Appellee feels that this question is answered by the unambiguous language of the statute and its plain meaning to the commercial world. However, this construction has been questioned and the answer to this question is one of wide significance and application. Of the 49 states which have adopted the Uniform Commercial Code,[2] 39 have adopted the second or third options of Section 9-401,[3] under which

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1. Cal. Stats. 1963. c. 819, § 9401(1)(a). References to the California Uniform Commercial Code will be in terms of ''California Commercial Code'' or ''California Code'' for brevity and to avoid confusion with references to the Uniform Commercial Code of the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

2. See Appendix I listing these states which includes all states except Louisiana. Note that all states have not adopted the code as drafted and differences exist in addition to the optional differences provided in the Code.

3. These states are indicated in Appendix I. Note that even those states adopting one of the options provided have not all adopted the option as drafted by the Institute and Conference. However, the second or third option as adopted by these states, although not identical, retain the language and substance to the extent that the issue before this Court could arise.

this question could arise, and 8 of these states are in the area of the Ninth Circuit.[4] The question is one of first impression before this court.

III

ARGUMENT

1. Determination of the Proper Place to File Under California Commercial Code Section 9401(1) Depends Upon the Use of the Collateral.

California Commercial Code Section 9401(1) reads, in part, as follows:

> "The proper place to file in order to perfect a security interest is as follows:
>
> "(a) When the collateral is equipment used in forming operations, . . ., then in the office of the county recorder . . .
>
> "(b) When the collateral is crops or timber to be cut, then in the office of the county recorder . . . "

Each of the paragraphs describing transactions requiring local filing begins with the phrase, "when the collateral is". The statute thus provides a classification dependent on the nature of the goods or collateral. Sub-paragraph (a) continues with the phrase "equipment used in farming operations", further defiining this classification according to the "use" of the collateral.

It seems to appellee that the language of Section 9401(1) (a) is clear and without ambiguity. It requires local filing "when the collateral is equipment used in farming operations".

The equipment, subject of this case, consisted of grain harvesters that were manufactured and used exclusively for the harvesting of grain, and had no non-farming utility.

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4. These states are Alaska, Arizona, California, Idaho, Montana, Nevada, Oregon and Washington. Sources of information are included in Appendix I.

2. The Interpretation of Section 9401(1)(a) Urged by Appellant Is in Fact a Classification Different from That Provided in the Statute.

The essence of Appellants' argument is that the occupational or contractual arrangement of the debtor, and not the use of the collateral, is determinative of inclusion under Section 9401(1)(a). The classification implicit in this argument is "When the collateral is equipment of a farmer used in his farming operations."[5]

This simply is not the class found in the statute. Moreover, the classification urged by appellants is one easily within the capacity of the draftsmen to express had they so intended.[6] The trustee finds it difficult to believe, as appellant infers (A.B. 15-16), that the language of Section 9-401(1)[7] contains a material omission of terms which the draftsmen were fortunate enough to express in other parts of Division 9 where desired.[8]

Appellee believes they consciously avoided, with good reason, a classification of the nature here urged by appel-

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5. Appellants use the pharse "proprietors . . . engaged in a farming operation" (A.B. 16) All reference to Appellants' Opening Brief will be in this form, indicating page number.

6. Inasmuch as California adopted for this purpose the uniform draft and one of the purposes of the Code is to achieve uniformity among the states, it seems to appellee that the legislative intent must be presumed to be the intent of the Code draftsmen.

7. All references to sections of the Uniform Commercial Code are in the form of § 9-401 as contrasted with California's numbering form of § 9401. Reference is to the 1962 Official Text of the Uniform Commercial Code, as amended in 1966, of the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

8. The American Law Institute and the National Conference of Commissioners on Uniform State Laws worked on the Code from 1943 until September of 1951 when its form was adopted by these bodies. A revision was produced in 1956 with the assistance of the New York Law Revision Commission by the Code's Editorial Board. (Martindale-Hubbell Law Directory, Vol. 5, p. 3661 (100th Ed. 1968).

lant. The traditional American farmer who lives on his farm and personally performs all functions, i.e. preparation, seeding, weed control, irrigation, cutting, picking, harvesting, etc. no longer dominates modern farming. With the increased demands in terms of size, efficiency and technical knowledge demanded by today's farm economy and technology, an ever increasing variety of capacities and contractual arrangements appear. Many persons are involved directly in performing functions which are part of the historical farming process, i.e. planting, harvesting, etc. are not farmers in the traditional meaning. The draftsmen of Division 9 undoubtedly realized that a classification for purposes of Section 9-401 in terms of reference to occupational or contractual status of the debtor would be substantially more troublesome in application to modern agriculture than the one adopted, "equipment used in farming operations."

The problem can be demonstrated by the following examples:

(a) Mr. Jones, who farms 1000 acres of cotton, owns 3 cotton pickers. Mr. Jones uses these pickers to harvest his cotton and to harvest about 2000 acres of cotton on neighboring farms on a contract basis. Is Mr. Jones a farmer with reference to the primary use of this equipment?

(b) Mr. Smith is a citrus expert and contracts for the management of citrus orchards on a price per acre per year. Smith contracts with professional people investing in orchards and with farmers. Smith's equipment and employees may perform by contract virtually all services or a number of them and less than all. Smith may merely contract for the development and planting or to take the trees into production. Is Smith a farmer? Is Smith's equipment used in *his* farming operations?

(c) Mr. Taylor is a citrus farmer. Taylor is also in the business of contract management of orchards for other owners. Does Mr. Taylor have to determine at time of purchase in which part of his operations he will primarily use it? How does the creditor entitled to "notice" under the Code determine of which office he is to inquire?

(d) Mr. Black raises meat turkeys under a common industry contract under which Black leases his property and turkey facilities and equipment to a feed company for one year and the company employs Black on a price per bird or pound marketed to raise and care for the turkeys. Is the turkey production Black's farming operation? Is he a farmer?

(e) White Chocolate Company in order to further integrate its operation decides to plant 5000 acres of almonds in the San Joaquin Valley. White purchases equipment and hires employees to plant and maintain the orchard. Is White Chocolate Company a farmer?

Suppose White employs Smith on a contract basis to take care of the orchard using White's equipment.

(f) Westside, Inc. is one of a number of corporations in a multi-corporate farming operation. Westside, Inc. owns and maintains a large number of items of equipment which are leased or rented to several other corporations as needed. Is Westside a farmer?

Presumably, under the construction offered by Sequoia, central filing would be required in examples (a), (d) and (f), and both local and central filing in (c) and (e), even though in each of the examples set forth the equipment is obviously "equipment used in farming operations." If one injects into Section 9401(1)(a) a requirement that the equipment be owned or held by a "farmer" or used by a farmer in his farming operations, a laborious task is cre-

ated and different answers would result. This problem, appellee believes, is precisely the reason for the use in 9401 (1) of the phrase "equipment used in farming operations".

The great bulk of farm equipment is manufactured and suitable for only a particular farm use. Examples are most seed planters, cultivators, harrows, poultry feeders, poultry nests, bulk feed tanks, cotton pickers, grain harvesters, tomato pickers, potato harvesters, hay mowers and balers, and so on. This category of "farm-use only" equipment would probably include substantially all mechanized harvesters, such as the equipment here involved. In dealing with such equipment the dealer knows that the equipment is for use in a farming operation without the necessity of inquiring as to the nature of the relationship between the debtor and the crop or livestock.

The concept which it appears the draftsmen have attempted to use is reflected in the phrase repeatedly used in discussions of Section 9-401 "farm-connected collateral".[9] Appellee believes this reflects a realization that commercial people think in terms of farm and non-farm operations and that this concept will prove understandable and useable by them.[10]

Some equipment is used commonly in both farm and non-farm businesses. Some conventional tractors and tracklayer tractors are used extensively in construction. Dealers are generally aware of the dual use and can usually determine the farm or non-farm use by knowing or ascertaining the business of the buyer in terms of farming or non-farming.

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9. See, e.g., 1 Secured Transactions under U.C.C. 591 (Mathew Bender & Co. 1966); 3 Boston Coll. & Comm. L. Rev. 179, at 186 and 188 (1961-62); or "farm-related collateral", in 29 M. L. Rev. 517, at 525 (1964).

10. In an address by Russell R. Campbell, Senior Vice-President of James R. Talcott Co., printed in 46 Chicago Bar Record 209, Campbell refers to this equipment as "farm equipment", at 211.

Note that this inquiry still does not demand knowledge of or conclusions from detailed contractual arrangements, but only the basic nature of the business. This information can be obtained by a simple form added to the sales order or contract form.[11]

There are undoubtedly some items of essentially "farm equipment" used occasionally in connection with other purposes. The problem of ascertaining the use of this equipment for filing purposes is, however, the same under either of the interpretations of 9401(1)(a) here urged.

The discussion above, appellee submits, points out (a) the reason why the draftsmen did not use appellants' "interpretation" in drafting Section 9401(1)(a), and (b) that the plain meaning of the statute is relatively easy of application to commerce while appellants' concept would be almost impossible of such application.

The trustee does not suggest that the class of goods provided in Section 9401(1)(a) is altogether free from problems in its application. There will be many circumstances where its application will be ambiguous for years. These problems would, however, appear to be minimal as compared with the problems inherent in appellants' classification.

3. Local Filing Has No Necessary Relation to the Local or Non-Local Use of Specific Collateral.

The Uniform Commercial Code Section 9-104 was drafted with three alternatives varying as to degree of centralized filing.[12]

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11. An example is set forth in Appendix II.

12. See § 9-401 of Official Text, Discussions of the alternatives offered can be found in the Comments No. 1-4 of the Uniform Commercial Code Comment; Forms and Procedures Under U.C.C., Appendix to Article 9, p. 761 (Hart & Willier 1965).

The reasons behind the California legislature's adoption of the second alternative is not pertinent. Although presumably reflecting an attitude that farming is sufficiently "local" to warrant an "exception" to central filing, it certainly does not reflect a legislative opinion or judgment that all farming operations are "local" or that all equipment used in farming operations reflects "local" transactions. There are no doubt many items of farm equipment owned by both farmers and non-farmers not "locally" used. However, a legislative classification made in terms of "local transactions" would obviously create a nightmare in attempted application to commerce. Although the classification of transactions in terms of collateral requiring local and central filing reflects a policy toward localizing or centralizing filing for certain goods, many transactions requiring central filing are undoubtedly "local" and vice-versa. The code does not adopt a transaction approach.

4. Classification of Goods as Mutually Exclusive.

The concept of mutual exclusiveness of classifications of goods in Section 9109 is no doubt applicable to Section 9401. It does indicate that goods cannot at the same time as to the same person be included in more than one class. It does not, however, render assistance in the determination of the class into which the collateral in question falls.

The only relevance of this concept to the issue in this case is that it makes clear a filing in either the central or local office is not sufficient. The financing must be filed in the place specified by the code.

5. Proper Construction of the Commercial Code in This Case Demands That the District Court's Determination Be Upheld.

Liberal construction of the commercial code in order to promote its underlying purposes supports appellee's and not appellants' case.

Appellants point out that the California Commercial Code by its own terms calls for a liberal construction of the code to promote its underlying purposes and policies (A.B. 17), and argue from this that the equitable consideration should prompt this Court to overturn the judgment below in favor of appellants which stand to lose several thousands of dollars. The liberal construction of the code in order to promote its underlying purposes and policies, calls in this case for an interpretation of the statute which would tend to uphold the validity of transactions in general, without regard to the single transaction before the Court. Section 1102 of the California Code, in addition to calling for a liberal construction to promote its underlying purposes and policies, sets forth those underlying purposes and policies:

> "(2) Underlying purposes and policies of this code are
> (a) To simplify, clarify and modernize the law governing commercial transactions;
> (b) To permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
> (c) To make uniform the law among jurisdictions."

It is difficult to see how the construction urged by appellant tends to simplify, clarify or modernize any law.

With reference to sub-paragraph (b), the Official Uniform Commercial Code Comment [13] explains:

> "This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices."

13. Comment No. 1 of Uniform Commercial Code Comment to § 1-102.

In speaking of a provision in the Uniform Trust Receipts Act similar to Section 1102(2)(c) a California appellate court observes:

> "This rule of construction has for its purpose the object of unifying the laws of the several states which enact it. The fundamental purpose of the Act in question should be considered in light of the general commercial law of the country as a whole."[14]

With the identical or similar statute in effect in 39 states, including 8 states in this circuit and including most of the major farming areas in the United States, it must be assumed that possibly tens of thousands of transactions involving millions of dollars which may be controlled by this statute could be effected. It seems to appellee that the Court must assume that the reasonable, obvious and logical meaning of the statute will be applied generally in commercial transactions, and that an interpretation of the statute otherwise would, although perhaps tending to uphold the single transaction before the Court, tend to destroy the validity of transactions in general entered into with this statute in mind and thereby fail to promote the underlying purposes of the Commercial Code. The "liberal" construction urged by appellants is in fact a request to "validate" their security interests even though the result may be to "invalidate" thousands or tens of thousands of others. This is not what the term "liberal" means as used in Section 1102.

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14. Chichester v. Commercial Credit Co., 37 Cal. App. 2d 439, at 448 (1940).

CONCLUSION

Section 9401(1)(a) is clear and unambiguous. It classifies transactions in terms of the use of the collateral. The construction of appellants in terms of the person holding the equipment is (a) simply not to be found in the statute, (b) could be easily expressed in language used by the draftsmen in the same division of the Code, and (c) was probably intentionally avoided by the draftsmen in Section 9-401 as the application of such language would not be commercially feasible.

In interpretation of Section 9401(1)(a) achieved by reading in a classification different from the plain meaning of its terms would tend to destroy the validity of security transactions in general and would be contrary to the policy of the Code.

Respectfully submitted,

Fullerton, Lang & Richert
Frank H. Lang, Jr.

Attorneys for Trustee-Appellee.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Frank H. Lang, Jr.

(Appendices Follow)

Appendix I

States Which Have Adopted Uniform Commercial Code	Option of 9-401 Used†	States Which Have Adopted Uniform Commercial Code	Option of 9-401 Used†
Alabama	2	Nebraska	none
Alaska*	2	Nevada*	3
Arizona*	2	New Hampshire	3
Arkansas	3	New Jersey	2
California*	2	New Mexico	none
Colorado	2	New York	3
Connecticut	1	North Carolina	3
Delaware	1	North Dakota	2
Florida	2	Ohio	2
Georgia	none	Oklahoma	2
Hawaii*	1	Oregon*	3
Idaho*	2	Pennsylvania	3
Illinois	2	Rhode Island	2
Indiana	2	South Carolina	2
Iowa	2	South Dakota	2
Kansas	2	Tennessee	2
Kentucky	3	Texas	2
Maine	3	Utah	1
Maryland	none	Vermont	3
Massachusetts	3	Virginia	3
Michigan	none	Washington*	2
Minnesota	2	West Virginia	3
Mississippi	3	Wisconsin	3
Missouri	3	Wyoming	none
Montana*	2		

†The options used have been modified by some states.

*States within the Ninth Circuit area.

Sources of information:
1 Uniform Commercial Code Rep. Service, State Correllation Tables; and Martindale-Hubbell Law Directory, Vol. 5, p. 3661 (100th Ed. 1968)

Farm Products, Timber and Business Equipment

On the terms and conditions stated in the Security Agreement printed on the reverse side of this paper, the undersigned (Debtor) transfers to WELLS FARGO BANK (Bank) a security interest in any and all business equipment and farm products, including farm equipment, supplies, feed, livestock, poultry, products, timber and crops now or at any time hereafter located, growing or to be grown on the real property described as follows:

____.

☐ A corporation, partnership, association or other organization, whose chief place of business is at ____

____.

Dated: ____________________.

____
(Debtor)

By ______________________________

Its ______________________________

If collateral includes motor vehicles or boats, have Bank registered as legal owner.

N37U (11–64)

Farm Products, Timber and Business Equipment

On the terms and conditions stated in the Security Agreement printed on the reverse side of this paper, the undersigned (Debtor) transfers to WELLS FARGO BANK (Bank) a security interest in any and all business equipment and farm products, including farm equipment, supplies, feed, livestock, poultry, products, timber and crops now or at any time hereafter located, growing or to be grown on the real property described as follows:

including the following particularly described collateral now owned by Debtor and located thereon:

and including all proceeds thereof and all such collateral after it has been severed and removed from said real property.

Debtor represents and warrants:

A. The particularly described collateral is located on the property above described and is used primarily for:

☐ (a) Business, other than farm, purposes.

☐ (b) Farm purposes.

B. The Debtor is:

☐ An individual, or husband and wife, who reside at ____________________

____________________.

☐ A corporation, partnership, association or other organization, whose chief place of business is at ____________________

____________________.

Dated: ____________________.

____

(Debtor)

By ____________________

Its ____________________

If collateral includes motor vehicles or boats, have Bank registered as legal owner.

N37U (11–64)

SECURITY AGREEMENT

As an inducement to WELLS FARGO BANK (Secured Party) to extend or continue credit to the Debtor (Debtor) named on the reverse side hereof, or any of them, but without obligation on its part to do so, and as security as hereafter provided, Debtor agrees:

1. CREATION OF SECURITY INTEREST. Pursuant to the provisions of the California Uniform Commercial Code, Debtor hereby grants to Secured Party a security interest in the collateral described in Paragraph 2 to secure the payment or performance of Debtor's obligations to Secured Party described in Paragraph 3.

2. COLLATERAL. The collateral covered by this Security Agreement is of the description found on the reverse side hereof, and all products, natural increase, improvements, accessions, and additions thereto and replacements and proceeds thereof.

3. DEBTOR'S OBLIGATIONS SECURED HEREBY. The obligations secured hereby are:

(a) Payment and performance of all existing and future obligations of Debtor to Secured Party including those arising under this agreement, and

(b) The expenses, including attorneys' fees and legal expenses, incurred or paid by Secured Party in the preservation or enforcement of the rights of Secured Party, or the obligations of Debtor hereunder, including such expenses incurred by Secured Party in performing for Debtor's account any obligation of Debtor.

4. COLLATERAL - SALE OR TRANSFER. Debtor will not sell or offer to sell or otherwise transfer the collateral, or any part thereof, or any interest therein, without the prior written consent of Secured Party.

5. COLLATERAL - LOCATION. Except upon the prior written consent of Secured Party the collateral shall be kept and maintained at the address or location, if any, specified on the reverse side hereof as the location of the collateral.

6. COLLATERAL - NOT COVERED BY OTHER FINANCING STATEMENT. No financing Statement covering any of the collateral or proceeds thereof is on file in any public office.

7. PROTECTION OF COLLATERAL - USE. The collateral will not be used for any unlawful purpose, nor be used for hire, nor be used in any way that will void any insurance required to be carried in connection therewith. Debtor will keep the collateral free and clear of liens and adverse claims and as appropriate and applicable, will keep it in good condition and repair, and clean, feed, shelter, water, medicate, fertilize, cultivate, irrigate, prune and otherwise deal with the collateral in all such ways as are considered good practice by owners of like collateral.

8. PROTECTION OF COLLATERAL - INSURANCE. The collateral will be insured against all risks commonly insured by owners of like collateral and those which Secured Party may designate, with policies acceptable to Secured Party and payable to both Secured Party and Debtor, as their interests appear, and with duplicate policies deposited with Secured Party. Debtor agrees to pay when due all premiums for such insurance and all taxes, license fees and other charges in connection with the collateral. Any advances made by the Secured Party for any such purposes shall bear interest at one per cent (1%) per month and shall become due on demand. If Secured Party shall take possession of the collateral, Secured Party may surrender the policies and receive and retain the unearned premiums thereon.

9. POSSESSION OF COLLATERAL. On default hereunder or under any obligation secured hereby, or if at any time the Secured Party believes that the collateral is in jeopardy, or if he otherwise deems himself insecure, he may, without notice to Debtor, take possession of the collateral and may enter and remain upon the premises for the purposes hereof. Upon written notice to Debtor, Debtor will assemble the collateral and make it available to Secured Party at such place to be designated in said notice as is reasonably convenient to both parties. The entrance to the location where said collateral is now located, if specified on the reverse side hereof, is one such place.

10. ACCELERATION. On default hereunder or under any obligation secured hereby, or whenever Secured Party deems himself insecure, Secured Party may, without notice to Debtor, accelerate the payment or performance of any or all of Debtor's obligations hereunder.

11. ADDITIONAL COLLATERAL FOR INSECURITY. Debtor will, upon request by Secured Party, provide additional collateral satisfactory to Secured Party as security for the performance of any or all of Debtor's obligations hereunder whenever the Secured Party deems himself insecure.

12. USE AND OPERATION OF COLLATERAL BY SECURED PARTY. Whenever the collateral is in the possession of Secured Party he may use, operate and consume the collateral as appropriate for the purpose of performing Debtor's obligations with respect thereto.

13. DISPOSITION OF COLLATERAL IN A COMMERCIALLY REASONABLE MANNER. It is agreed that public or private sales, for cash or on credit, to a wholesaler or retailer or user of collateral of the types subject to this Security Agreement, or at public auction, are all commercially reasonable since differences in the sales prices generally realized in the different kinds of sales are ordinarily offset by the differences in the costs and credit risks of such sales.

14. PLACE OF SALE. Any public sale may be at Debtor's place of business or any other place permitted by law.

15. POWER OF ATTORNEY. Debtor appoints Secured Party the attorney in fact of Debtor to prepare, sign and file or record, for Debtor in Debtor's name, any financing statements, applications for registration and like papers and to take any other action deemed by Secured Party necessary or desirable in order to perfect security interests of Secured Party hereunder, and to perform any obligation of Debtor, at Debtor's expense, but without obligation to do so.

No. 22,194

United States Court of Appeals

For the Ninth Circuit

SEQUOIA MACHINERY, INC., a Corporation, and KAWEAH COMPANY, a Corporation,
Appellants,

vs.

J. RODERICK JARRETT, Trustee of the Estate of James C. Clark, Bankrupt,
Appellee.

AMICUS CURIAE BRIEF OF CALIFORNIA EQUIPMENT DEALERS ASSOCIATION, A CORPORATION

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California Equipment
Dealers Association.*

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No. 22,194

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vs.

J. Roderick Jarrett, Trustee of the Estate of James C. Clark, Bankrupt, *Appellee.*

AMICUS CURIAE BRIEF OF CALIFORNIA EQUIPMENT DEALERS ASSOCIATION, A CORPORATION

I

SUMMARY OF ARGUMENT

Section 9401 (1) (a) of the California Commercial Code requires financing statements to be filed locally when the collateral is "equipment used in farming operations." Section 9401 (1) (c) provides for central filing with the Secretary of State "in all other cases."

The code provides no definitions or other machinery for determining when equipment is "equipment used in farming operations." Dealers in equipment of various types are required under the code to interpret

the meaning of the language "equipment used in farming operations" in order to properly file.

There is need for judicial clarification of the language "equipment used in farming operations." There is need for definitions or guidelines to assist dealers in equipment to determine when equipment is of the type referred to in Section 9401 (1) (a) of the California Commercial Code.

Until such time as adequate guidelines have been established, justice and fairness, the purposes and policies of the California Commercial Code, and the rules of statutory construction and interpretation require a decision that security agreements will be enforced if there has been a reasonable and good faith attempt on the part of the dealer to determine if the collateral was or was not "equipment used in farming operations," and to file in the proper place.

II

ARGUMENT

1. THERE IS PATENT AMBIGUITY IN THE LANGUAGE OF SECTION 9401 OF THE COMMERCIAL CODE.

Section 9401 (1) (a) of the California Commercial Code provides that the proper place for filing "when the collateral is equipment used in farming operations" is in the office of the county recorder. However, no place in the California Commercial Code, or in the Uniform Commercial Code, upon which the California act is based, is there set forth any definition or guidelines for determining when equipment is "equipment

used in farming operations." There is nothing in the official Code Comments by way of definition. There is no help to be found in the general law or by way of precedent.

That serious questions exist is best evidenced by the very matters presented in the case on appeal; by the issues raised by amicus curiae, Allis-Chalmers Manufacturing Company; and by the Affidavit in Support of Motion for Leave to File Amicus Curiae Brief, signed by executive officers of the California Equipment Dealers Association (Exhibit "B" of exhibits filed in support of Motion for Leave to File Amicus Curiae Brief).

Even the authors of textbooks on the California Commercial Code appear to be puzzled by the language "equipment used in farming operations." In Volume III, California Commercial Law (California Continuing Education of the Bar), the following lanquage appears:

> "When the transaction is made to consumers *or by farmers,* or the collateral is crops or timber connected to real property, local filing is required."[1] (Emphasis added).
>
> "Local filing is proper for equipment used in farming operations. The *code contains no definition of farming operations,* but Section 9-109, Comment (4), states that 'farming operations' includes *raising livestock as well as crops.*"[2] (Emphasis added).

---

[1]Volume III, California Commercial Law (California Continuing Education of the Bar), chapter 5, page 258.

[2]Volume III, California Commercial Law (California Continuing Education of the Bar), chapter 5, page 259.

> "The code defines equipment but gives no special definition of farm equipment. Based on the general definition, farm equipment is equipment used or bought for use primarily in the *business of farming.*"[3] (Emphasis added).

Counsel for Appellee apparently appreciates that ambiguity is a problem. On page 9 of Appellee's Brief it states as follows:

> "The trustee does not suggest that the class of goods provided in Section 9401 (1) (a) is altogether free from problems in its application. There will be many circumstances where its application will be ambiguous for years."

---

2. THE BURDEN OF RESOLVING THE AMBIGUITY IS PLACED UPON THE SELLER OF EQUIPMENT.

Because the code does not adequately set forth when equipment is to be considered "equipment used in farming operations"; and because the seller is charged with the responsibility of filing in the proper place; in each indivdual transaction there falls upon the seller the burden of interpreting the meaning of Section 9401 (1) (a), and the burden of deciding what is the proper place to file the financing statement.

It is to be noted that this burden is placed upon the seller without invitation or request by him.

Counsel for Appellee notes that there are circumstances when the dealer must investigate and deter-

---

[3]Volume III, California Commercial Law (California Continuing Education of the Bar), chapter 10, page 506.

mine the nature of the purchaser's business.[4] Counsel for Appellee further, very candidly, points out that the problems of ascertaining the use of certain types of equipment would be the same under either the interpretation urged by Appellants or the interpretation urged by Appellee.[5]

The types of transactions which would require the individual interpretation of the dealer as to whether the collateral is "equipment used in farming operations" are too numerous for any attempt to describe each possible situation that might arise; however, the following are examples of the range of possible transactions:

1. A dealer sells equipment, normally used in farm work, to a farmer who works only his own farm;
2. A dealer sells equipment, normally used in farm work, to a farmer who works his own farm and contracts work for other farmers;
3. A dealer sells equipment, normally used in farm work, to a purchaser who does no farming, but contracts out the use of his equipment;
4. A dealer sells equipment, normally not used in farm work, to one who is a farmer and has no other business;
5. A dealer sells equipment, normally not used in farm work, to one who both farms his own farm and contracts business out;

---

[4]Appellee's Brief, page 8.
[5]Appellee's Brief, page 9.

6. A dealer sells equipment, normally not used in farm work, to one who contracts work for others who are farmers;
7. A dealer sells equipment that can be used for both farm and non-farm work to one who works only his own farm;
8. A dealer sells equipment that can be used for both farm and non-farm work to one who owns and operates a farm but is also in the construction business;
9. A dealer sells equipment that can be used for both farm and non-farm work to one who is in the construction business; but to make ends meet, is not above contracting out the use of his equipment to farmers, during his off season.

---

3. THE CALIFORNIA COMMERCIAL CODE ANNOUNCES A PURPOSE AND POLICY OF ENFORCING THE VALIDITY OF SECURITY TRANSACTIONS.

Division 9 of the California Commercial Code sets forth the law pertaining to secured transactions. The Uniform Commercial Code Comment under Sec-9101, states that "the aim of this Article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty."[6]

---

[6] West's Annotated California Commercial Code, Volume 23C, page 303.

Section 1102 of the California Commercial Code, provides in part as follows:

> "(1) This code shall be liberally construed and applied to promote its underlying purposes and policies."
>
> "(2) Underlying purposes and policies of this code are
>
> (a) To simplify, clarify and modernize the law governing commercial transactions;
>
> (b) *To permit the continued expansion of commercial practices* through custom, usage and agreement of the parties;
>
> (c) To make uniform the law among the various jurisdictions." (Emphasis added).

The Uniform Commercial Code Comment under Section 1102, states as follows:

> "1. Subsections (1) and (2) are intended to make clear that:
>
> This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. *It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices.* However, *the proper construction of the Act requires that its interpretation and application be limited to reason.*" (Emphasis added).
>
> "The Act should be construed in accordance with its underlying purposes and policies."[7]

---

[7]West's Annotated California Commercial Code, Volume 23A, pages 13 and 14.

It is obvious that the California Commercial Code was adopted with a legislative intent of expanding commercial transactions and of upholding their validity, rather than with an intent of placing restrictions thereon.

It is also obvious that the legislative intent was for judicial decisions upholding the validity of security transactions whenever reasonable to do so.

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4. **THE RULES OF STATUTORY CONSTRUCTION AND INTERPRETATION REQUIRE A POLICY OF ENFORCING SECURITY TRANSACTIONS.**

There are certain basic and elementary principles which should be considered by the Court when called upon to interpret and apply legislation.

Foremost among these basic principles is the requirement that if a statute is ambiguous it should be so construed as to render a result that would not negate its purpose.[8]

Second, whenever possible, "a statute should be construed to reach a result that is *reasonable;* and that a construction which will lead to absurd, unfair and unjust consequences should not be given if it can be avoided."[9]

---

[8] *East Bay Garbage Co. v. Washington Township Sanitation Company*, 52 Cal. 2d 708, (1959);
Ivens v. Simon, 212 Cal. App. 2d 177, (1963);
Estate of Wyman, 208 Cal. App. 2d 489, (1962);
Estate of Jacobs, 100 Cal. App. 2d 452, (1950).

[9] *Estate of Jacobs*, 100 Cal. App. 2d 452, at page 458, (1950);
Ivens v. Simon, 212 Cal. App. 2d 177, (1963);
Estate of Wyman, 208 Cal. App. 2d 489, (1962).

Third, when a statute is ambiguous, it should be construed so as not to deprive the person interested of a substantial right.[10]

Finally, consideration must be given to the consequences that will result from a particular interpretation; with a view toward avoiding unjust and unnecessary or absurd hardships.[11]

Having in mind the above principles of statutory construction, amicus curiae respectfully asks that the Court consider the following matters:

1. Because of the various complexities involved in each individual transaction, different interpretations have arisen among businessmen as to when collateral was "equipment used in farming operations." The dilemma is clearly evidenced by the case on appeal, by the matter presented by Allis-Chalmers Manufacturing Company, and by the affidavit filed by the executive officers of the California Equipment Dealers Association.

2. The position taken by Appellants, and their reasons for interpreting Section 9401 (1) (a) as they did, are both impressive and reasonable.

3. By the same token, the position taken by Appellee and by Allis-Chalmers, and their reasons for interpreting Section 9401 (1) (a) as they did are equally as impressive and reasonable.

---

[10] *Estate of Jacobs,* 100 Cal. App. 2d 452, (1950);
People v. Hodgdon, 55 Cal. 72, (1880).

[11] *Moeser v. County of San Diego,* 227 Cal. App. 2d 563, (1964);
Ivens v. Simon, 212 Cal. App. 2d 177, (1963);
Estate of Jacobs, 100 Cal. App. 2d 452, (1950).

4. Should the Court, in rendering its decision, adopt one interpretation to the exclusion of the other, the consequences will render untold hardships on those dealers and businessmen who, having no other guidelines to go by, interpreted Section 9401 (1) (a) differently.

5. Should the Court, in rendering its decision, adopt one interpretation to the exclusion of the other, the consequences will result in the voiding of numerous security transactions which are otherwise valid. Surely this would defeat the very purpose of the California Commercial Code, which is to expand such transactions and to make the same secure.

6. It is respectfully submitted that the legislature, in placing upon the dealer or businessman the burden of determining when collateral was "equipment used in farming operations," without setting forth guidelines therefor, must have intended that any reasonable and good faith attempt by the dealer to determine if the equipment was "used in farming operations" and to file in the proper place, would be in compliance with the filing requirements of Section 9401 (1).

7. It is further respectfully submitted that such a decision by the Court, should render effective the security transaction effected by Appellant in the case before the Court; should render effective the security transactions mentioned and referred to by Allis-Chalmers; should render effective the security transactions of all dealers and businessmen who in good faith have reasonably attempted to comply with the filing requirements of Section 9401 (1); and should be con-

sistent with the expressed purposes and policies of the California Commercial Code.

CONCLUSION

For all of the reasons set forth herein, amicus curiae respectfully requests that the Court give consideration to the following factors:

1. The need for a definition of, or guidelines for determining, the meaning of the language "equipment used in farming operations" as contained in Section 9401 (1) of the California Commercial Code, insofar as future transactions may be concerned;

2. Insofar as past transactions are concerned, the just and fair consequences of a decision to the effect that all good faith and reasonable attempts to determine if the collateral was or was not "equipment used in farming operations" and to comply with the filing requirements of Section 9401 shall be deemed valid and enforceable for the purpose of protecting the security interest involved.

Respectfully submitted,

Crowe, Mitchell, Hurlbutt,
Clevenger & Long,

By Robert P. Long,

Attorneys for Amicus Curiae
California Equipment
Dealers Association.

CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the Rules of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with said rules.

ROBERT P. LONG.
Attorney for Amicus Curiae.

No. 22,194

IN THE

United States Court of Appeals

For the Ninth Circuit

SEQUOIA MACHINERY, INC., a Corporation, and KAWEAH COMPANY, a Corporation,
Appellants,

vs.

J. RODERICK JARRETT, Trustee of the Estate of James C. Clark, Bankrupt,
Appellee.

AMICUS CURIAE BRIEF OF ALLIS-CHALMERS MANUFACTURING COMPANY SUPPORTING APPELLEE

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Rules

No. 22,194

IN THE

United States Court of Appeals

For the Ninth Circuit

SEQUOIA MACHINERY, INC., a Corporation, and KAWEAH COMPANY, a Corporation,
Appellants,

vs.

J. RODERICK JARRETT, Trustee of the Estate of James C. Clark, Bankrupt,
Appellee.

AMICUS CURIAE BRIEF OF ALLIS-CHALMERS MANUFACTURING COMPANY SUPPORTING APPELLEE

I

WHAT THIS CASE IS ABOUT

Appellants filed financing statements covering grain harvesters with the Secretary of State.

The Bankruptcy Referee ruled that grain harvesters were equipment used in farming operations as defined by Section 9401 (1)(a) of the Commercial Code and that the proper place to file, as directed by the Code, was in the county of the residence of the owner. Appellants appealed first to the United States District Court, Eastern District of California, M. D. Crocker, District Judge. The Judge's Order Affirming the Referee's Order contains the following language:

> "The only matter here on review is the construction of Section 9401 (1)(a) of the California Commercial Code, particularly 'equipment used in farming operations.'
>
> "I think the Referee's determination in this matter was reasonable, as a harvester is used exclusively in harvesting agricultural crops, which is a 'farming operation.' It is immaterial that the services were rendered by a commercial harvester, an independent contractor, and not by a farmer-owner of such equipment. The services rendered by debtor were performed as an incident to ordinary farming operations and hence come within the broad language employed in Section 9401 (1)(a) of the California Commercial Code. If the legislature intended that this provision apply only to farmer-owners of agriculture equipment it would have so stated. The language of the pertinent provision is not so restrictive. There-

> fore, this Court concludes that the provision embraces all transactions that involve equipment used in farming operations.
>
> "Therefore the Referee's order is affirmed . . ."

Appellants are in the Ninth Circuit Court asking the Court to reverse Judge Crocker's decision. Appellee asks that the decision be sustained.

II

GRAIN HARVESTERS ARE EQUIPMENT USED IN FARMING OPERATIONS

The grain harvesters, the subject of this controversy, are called "combines." They are made for the sole purpose of harvesting grain.

The harvesting operation can only be performed on the farm.

The combine severs the grain heads in the field, separates the grain from the straw and chaff and delivers the harvested grain to sacks or a bin from which the grain is hauled from the field on the farm to a point of storage.

Harvesting grain in the field on the farm is, of course, a farming operation, and the harvester, manufactured solely for this use and serving no use off the farm, is equipment used in a farming operation.

Appellants contend that harvesting grain is not a farming operation because the owner of the harvester is paid by the acre.

No such limitation was included in the definition used in Section 9401, "equipment used in farming operations."

III

STATEMENT OF INTEREST OF ALLIS-CHALMERS

The interest of Allis-Chalmers Manufacturing Company, Farm Equipment Division, in the pending case arises out of the bankruptcy of Benjamin F. Laymon, No. F-2609, in the United States District Court, Eastern District of California. A farm equipment dealer of Allis-Chalmers Manufacturing Company at Fresno sold Benjamin F. Laymon three tractors and four windrowers. The windrowers are a power driven mower with a built-in attachment to move the hay into the windrow. This farm machinery was sold on a Conditional Sales Contract and *a Financing Statement was duly filed in the County of Fresno, the residence and place of the farm of Mr. Laymon, the purchaser.* Mr. Laymon filed bankruptcy. It appeared from the evidence that he also used the equipment to do contract work for neighbors.

The Referee took the position that the decision to be made by the Ninth Circuit Court in this case, Sequoia Machinery, Inc., et al. v. J. Roderick Jarrett, et al., No. 22194, might, if Judge Crocker is reversed, permit the Trustee to take the equipment and sell it for the benefit of the general creditors. The unpaid balance due Allis-Chalmers Manufacturing Company is Fifty-two Thousand Dollars ($52,000).

Allis-Chalmers has 3,000 farm equipment dealers in the United States, most of whom are within the area covered by the 39 states which have adopted the second or third option of Section 9401 of the Commercial Code, which is the section directing the filing of financing statements covering equipment used in farming operations in the county of residence of the farmer.

In California alone, Allis-Chalmers has more than one and a half million dollars unpaid on financing statements filed in the office of the County Recorder in accordance with Section 9401 of the Commercial Code, the place of residence of the debtor involved.

Allis-Chalmers may lose Fifty-two Thousand Dollars ($52,000.00), the unpaid balance due from Benjamin F. Laymon, and have to revise its entire system of finance under the Commercial Code to meet the ruling of the Ninth Circuit Court if Judge Crocker is reversed.

See stipulated set of facts in the matter of the bankruptcy of Benjamin F. Laymon, No. F-2609, in the United States District Court, Eastern District of California, attached as an appendix exhibit.

THE SECTION AS IT NOW READS:
Chapter 4
FILING

§ 9401. Place of Filing; Erroneous Filing; Removal of Collateral. (1) The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is equipment used in farming operations or farm products other than crops, or accounts or contract rights arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this State then in the office of the county recorder in the county where the goods are kept;

(b) When the collateral is crops or timber to be cut, then in the office of the county recorder in the county where the land on which the crops are growing or to be grown or on which the timber is standing is located;

(c) In all other cases, in the office of the Secretary of State.

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this division and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this State continues effective even though the debtor's residence or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) If collateral is brought into this State from another jurisdiction, the rules stated in Section 9103 determine whether filing is necessary in this State.

(5) The county of residence of an organization is the county in which it has its chief place of business in fact. (Stats. 1963, c. 819, § 9401.

What the Appellant Wants the Court to Add to Section 9401

Provided, that if the equipment used in farming operations is not used on the ranch of the farmer but is used for hire in a farming operation on another farm, it is not equipment used for farming operations as governed by Section 9401(1)(a) but filing shall be under Section 9401(1)(c) in the office of the Secretary of State.

See: ("Summary of Appellants' Position," page 8, Appellants' Brief).

Throughout this brief, counsel for Amicus Curiae has called this proposed additional "legislation requested of the Court. Section 9401(1)(a) appearing on page 6 does not require interpretation. The language is plain and the proposed addition is not an interpretation but it is a change in the requirements as set forth by the legislature in the section.

IV

WHERE FINANCING STATEMENTS ARE TO BE FILED

If any banker, lawyer, farmer, salesman, or interested person wants to know where to file a financing statement, they would look in the index of the Commercial Code. On page 925 of the index they would find "PLACE, Security interest, filing, Section 9401." Turning to 9401, we find it is the first section of Chapter 4.

Chapter 4 is entitled "FILING." Section 9401, the first section under Chapter 4, begins with the words "PLACE OF FILING." Section (1) reads: *"The proper place to file* in order to perfect a security interest is as follows: . . ." Then follows subsection (1)(a), the first line of which reads, "When the *collateral is equipment used in farming operations, . . .* in the office of the county recorder in the county of the debtor's residence . . ." Subsection (3) of 9401 sets out the rule where the condition is changed after the filing. It reads:

> "A filing which is made in the proper place in this State *continues effective* even though the

> debtor's residence or the location of the collateral or *its use,* whichever controlled the original filing, *is thereafter changed.*"

No other section of the Code has a title *"PLACE OF FILING."*

V

WHAT THE WORDS "COLLATERAL IS EQUIPMENT USED IN FARMING OPERATIONS" MEAN

In the operations of Allis-Chalmers Manufacturing Company, there are agricultural sales branches and industrial sales branches. It became necessary to determine which was which when there was overlapping uses such as a mower used along a highway or a crawler tractor which could be used on a farm or to build a highway. The present administrative assistant of the agricultural division, covering the areas of California, Arizona and Nevada, evolved a definition which was workable and which is used to distinguish material which is equipment used in farming operations from the industrial division material. The definition reads:

> "All equipment or implements, used from the beginning in the preparation of the soil or seed bed, through the harvest for the growing of grain, feed, seeds or fiber, raising or care of livestock or poultry on a farm, is equipment used in farming operations."

This definition clearly meets the common meaning of the words "equipment used in farming operations."

By this definition, equipment used off the farm is not farm equipment, but it must be remembered that subsection (3) of Section 9401 provides that if it is first used in a farming operation, a filing made in the proper place continues effective even though the use changes.

When the index refers only to Section 9401 of the Commercial Code as Section governing the place for filing and the title of Chapter 4 is "FILING" and the title of Section 9401 begins "PLACE OF FILING," there being no other section to which we are directed to look for a place to file, the logical conclusion is that the language of Section 9401 is the place we are to look if we want to know where to file.

It is neither logical nor reasonable to believe that the legislature intended to conceal the place of filing in other sections with no guideline in the way of title or index to such sections.

VI

USE IS A PERMANENT IDENTIFIABLE THING

If the test proposed by appellants that the equipment be used on the farmer's farm or it is not farming equipment, or stated another way, if the equipment is used off the farmer's farm for hire in a farming operation, it is not equipment used in a farming operation, we have a transient test. On one day, or at one hour, the equipment is used on the farmer's farm in a farming operation, and the next half day it may be used on the neighbor's farm for pay. Is a

plow or a mower or a rake no longer a plow or a mower or a rake because it is used on the neighbor's farm? The legislature in writing Section 9401, did not say so, nor did they say anything that indicated that there was an exception if the equipment was used on the neighbor's farm for hire.

Use is something perceptive to the eye. It is a simple method of classification. In practically every instance, farm machinery has only one use, that is, in farming operations. The different implements are commonly known and understood and readily identified by bankers, farmers and machinery sales agents as "equipment used in a farming operation." It seems to the writer that no one in my county would think of a plow or a mower or a disk or a harrow or a hay rig or a hay baler or a corn picker as anything but "equipment used in a farming operation." This same, common understanding of the use of this language exists in every agricultural county in the State. It has the same meaning to farmers, bankers, equipment salesmen, workers on farms and to people generally familiar with the farming industry.

Method of payment for the use as a test for classification is not something that is known when the piece of equipment is identified at the bank when a loan is made. It is something that can vary from day to day, the equipment being used on the farmer's own ranch today and put out for hire tomorrow. Obviously, there are many reasons for the legislature not to add this method of determining what is farm equipment to Section 9401. How is the lender going to prove

whether the equipment was used on the farmer's farm or on the neighbor's farm for hire two or three years later when the question could be raised in a legal controversy?

If these good reasons applied to the legislature and they did not add the limiting words asked for by appellants they apply doubly to a Court that is asked to legislate by interpretation and establish a rule which will soften a hardship in appellants' case, but does not suit the language of the Code as commonly used and understood.

VII

SECTION 9401 IS A WORKING SECTION EVOLVED OUT OF USE

Section 9401 of the Commercial Code is a working section evolved out of use and experience. It is not a perfect section, but it is the best that the legislators have been able to evolve out of experience as a means of classifying goods where county filing governs.

The fact is that none of the legislators in the nine western states and, insofar as I have been able to find, in no other state, have put a limitation in the section in the language sought by appellants here.

The legislatures have not been able in this case, as in many cases, to make a law that will fit every hardship that arises, but has widely used a generic, rather than a limiting, description for local filing.

The word "equipment" is as broad and generic a word as can be found. The word "used" is as broad

and generic a word as can be used. The words "farming operations" are words of common use and understanding.

These words put together would be interpreted by anyone in the common use of language to mean what they say, without exceptions, without limiting words which appellants desire the Court to add to the section. Limiting words of the type sought by appellants were defined by President Theodore Roosevelt as "weasel words." He said: "Weasel words are words that rob other words of their meaning." The legislature did not use weasel words in drawing the section.

This becomes of great weight in California because it is one of the last of 39 states to adopt Section 9401 and the benefit of experience and problems arising in other states was available to the committee studying the Code for use in California and it was determined, as evidenced by the enactment by the legislature, to use the broad generic terms adopted.

VIII

BANKS LOAN LARGE AMOUNTS TO FARMERS TAKING FINANCING STATEMENTS ON EQUIPMENT USED IN FARMING OPERATIONS

Let us suppose that John Doe comes to the bank to borrow money and he offers the instruments which he is using to farm with as security. The banker says, "How are they being used?" Doe answers, "This morning I am finishing the harvesting on my own

place, this afternoon I am going to harvest Smith's corn for $15.00 an acre, and tomorrow I will be back in my other field, and the next day I'm going over to harvest Jones' corn." Is the test to be *use* or is the test to be *method of pay,* that is, was the equipment used for hire? *If the test is use for hire, we run instantly into confusion. What is the controlling fact for filing? The use at the hour he applied to the banker, the use at the time he signed the Chattel Mortgage and Financing Statement, or the use that is being made at the time the Financing Statement is recorded?*

Under the rule proposed by appellants (see page 8 of appellants' brief) since the equipment is used on occasions to do work for hire, it cannot be "equipment used in farming operations," but since it is also used on the man's own farm, it is the "equipment used in farming operations." In other words, it is equipment used in farming operations in the morning and commercial equipment in the afternoon, equipment used in farming operations on Monday and commercial equipment on Tuesday depending where it is being used and what it is being used for. This leads to the ridiculous situation where no one can know after the instrument is filed what the equipment was being used for at the time of filing and no one will know where to file.

Many, many users of equipment used in farming are farmers who own the equipment on their own farms and also serve neighbors on adjoining farms for hire.

These facts raise no legal question at all if we use the plain language of Section 9401 of the Commercial Code, but utter confusion if the Courts amend Section 9401 by adding limiting words as asked for by appellants.

Farming practices are changing. Crop rotation, usually cotton followed by alfalfa or permanent pasture, occurs approximately every three years in good farming practice.

This means that the farmer needs to have available a complete set of hay equipment and a complete set of cotton equipment. The vastly increasing cost of equipment can be illustrated. A tractor, not the largest crawler type, now costs approximately $80,000.00 without implements. A cotton picker costs from $18,000.00 to $25,000.00. Horse hay mowers used to cost about $60.00. A modern mower with hay treatment attachements costs about $4,000.00. Planters with the necessary fertilizing attachments now cost several thousand dollars.

This great increase in capital investment, necessary to keep down labor costs, creates a problem for any small farmer. He cannot afford to own all of the equipment necessary in his rotation of farming operations.

The practice of one farmer buying some of one type of equipment and another farmer buying some of the other types of equipment, with exchanges on a pay-by-the-acre basis as the fairest method of computing the recompense, is becoming more and more common.

If farmer Jones is going to the bank to finance for next year's crops and his hay mower with windrower attachment is being used by farmer Smith, a neighbor, for so much an acre, it is farm equipment used in farming operations as Section 9401 now reads.

But, if the amendment to the section, which appellants are requesting, is made, it is not farm equipment during the time it is being used on the neighbor's farm for hire, but becomes farm equipment again when it is returned to Jones' farm.

When use is the test, the type of equipment being visible and permanent, Section 9401 is easy to apply and filing will be in the County. If method of payment for use is the test, as asked for by appellants, the place for filing will be with the Secretary of State. Not only will this vary from day to day, but the lender will not, after a few months, be able to prove which use was effective the day he made the loan, on Jones' farm or Smith's, the neighbor's farm, for hire. So, we have exchanged certainty for uncertainty. The legislative enactment, as it stands, is sounder than the proposed amendment.

IX

WHERE THE USE CHANGES, THE LEGISLATURE HAS PROVIDED A RULE

The traveling track layer tractor, which was first engaged in farming operations and then in timbering, used as an illustrative argument on page 16 of appellants' brief, would be legally stopped in its tracks

as far as filing is concerned by subsection (3) of Section 9401 which provides that if the filing was in accordance with the use at the time of filing, change in use does not affect the validity of the filing.

X

A HARDSHIP CASE—WHO IS TO TAKE THE LOSS?

Part V of appellants' brief is devoted to the hardship which will result if the judges of the Ninth Circuit Court do not change the language of Section 9401. Appellants filed with the Secretary of State and stand to lose $32,000.00 by failing to file where Section 9401 directs, in the county of the residence of the farmer. On pages 4 and 5 of this brief, the interest of Allis-Chalmers Manufacturing Company is set forth. If the Court adopts the amendment asked for by the appellants to Section 9401, appellants will save $32,000.00, but Allis-Chalmers Manufacturing Company, and its dealers, stand to lose $52,000.00 Additionally, Allis-Chalmers has a million and a half outstanding and similar financing statements all filed in the counties where the debtors resided who purchased the farm equipment. Some of this equipment will be used by the farmers for hire on their neighbor's ranches. The whole financing system used by Allis-Chalmers and other dealers for farmers will have to be changed and classified by a code amendment if the Court adopts the *changes* asked for by appellants. It will still have to be determined whether the use at the time of making the papers or at the time of filing

governs. The farm credit flows *where there is certainty* and backs away from uncertainty.

If the Court amends Section 9401, banks and other credit institutions lending to farmers will face an uncertain situation which will affect the readiness with which loans will be made to people buying farm equipment.

XI

DIVISION 9 OF THE CALIFORNIA COMMERCIAL CODE, SECURED TRANSACTIONS, IS CLEAR IN THE DIRECTIONS GIVEN TO OBTAIN SECURITY

The California Commercial Code, Division 9, contains remarkably clear directions to anyone seeking security on personal property.

Sections 9301-9318 set forth priorities gained by complying with the provisions of Division 9 covering secured transactions.

Section 9402 sets forth *what is required* to be set forth in a financing statement.

Section 9401 tells interested persons *where to file* financing statements.

Section 9401 (3) takes care of equipment when there is a *subsequent change of use or residence* of the debtor, whichever controlled the original filing. The first use and first residence continue effective even though thereafter changed.

Section 9109 defines all classes of goods as either (1) equipment, (2) farm products, or (3) inventory.

Inventory is, of course, things *held for sale* in the course of business where the priority of a financing statement would be impractical to apply to a purchaser in the ordinary course of business.

The legislature also included in inventory, articles that are leased. *It is to be recalled that the harvesters in this case were not leased, but were operated under a contract for harvesting by the owner.*

Inventory also includes things that are sold under contracts of service, such as the nails, lumber and other items furnished by a contractor in building a building. The items are sold but they are sold indirectly in the furnishing of the service and they are inventory because they are held for sale.

Section 9103 is the *conflict of laws section.* It governs equipment brought into this state from another state. Among the items enumerated is commercial harvesting equipment. Section 9103 is clear. If the chief place of business of the debtor is in this state, this division (Division 9) then governs the validity and perfection of a security interest, and in effect, the proper filing. If the place of business of debtor is in another state, the jurisdiction where the chief place of the business of the debtor is shall govern.

Appellants argue as though Section 9103 directed the filing for items brought in this state by a debtor to be with the Secretary of State. It only requires a reading of the Section to discover that the legislature did not say in Section 9103 where the filing was to be, but did say the filing is to be governed by Division 9.

Since Section 9401, the place to file, clearly directs the filing for equipment used in farming operations, the rules set forth in Section 9401 apply when the debtor is a resident of this State.

Appellants do not like the word "debtor" selected by the legislature and asks this Court to substitute a narrower word in Section 9401(a). In place of the word "debtor" selected by the legislature, appellants ask this Court to say "farmer using the equipment in his own farming operations."

The word "debtor" is used as the defining word in Section 9401, the place of filing, in Section 9103, the conflict of laws section, and in Section 9109, the definitions section. It is interesting and informative to observe that in all these sections the word "debtor" had no limiting words set forth after it. The exception is in Section 9109 (3), farm products. Farm products, as defined by subsection (3) of Section 9109, only "if they are in the possession of a debtor" and then the limiting words, "engaged in raising, fattening, grazing or other farming operations." That is to say, when the goods move out of the hands of the farm producer into the market, they are no longer farm products.

The point is that when the legislature found a limitation to be placed on the word "debtor," they said so as in Section 9109 (3) just described. In all of the other places, in all the other sections, the word "debtor" was used without limiting words. As the legislature used limiting words when needed as in Section 9109 (3) to release farm products from the

security rule when they move into the open market, it would seem to follow that where they used the word "debtor" without limiting words, they did not feel that limiting words were necessary or proper.

XII

WHAT THE COMMERCIAL CODE NEEDS IS READING, NOT AMENDMENT

In my own experience, I found that what I needed to do was to examine the pertinent Commercial Code sections for what they direct you to do. The directions in the Commercial Code need reading and following and do not need an amendment as an escape route for something that was not done as directed by the Code.

In this case, all of the answers are ultimately found in Section 9401, "Where to File."

Section 9109, the definition and classification section, makes clear that harvesters are "equipment." No other part of the definition section detracts or limits the language as used in Section 9401.

In appellants' brief, they find the words "debtor engaged in raising, fattening, grazing or other farming operations" to be limiting words applied to equipment, although they are not used in the paragraph defining equipment, and then they carry that limitation over to Section 9401 as though subsection (3) of Section 9109 read not "or other farming operations" as it reads, but "or operations by a farmer" which it

does not read, and then in some manner this change of language is brought to bear on Section 9401.

The fact that the appellants did not follow the directions of the Code sections should not be used to penalize the entire agricultural equipment sales financing by creating uncertainties where the directions are now plain and certain.

Dated, Madera, California,
April 8, 1968.

Respectfully submitted,
Sherwood & Denslow Green,
By Sherwood Green,
Attorneys for Amicus Curiae
Allis-Chalmers Manufacturing Company.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Sherwood Green,
Attorney for Amicus Curiae
Allis-Chalmers Manufacturing Company.

(Appendix Follows)

Appendix

Appendix

United States District Court
Eastern District of California

No. F-2609

In Bankruptcy

In the Matter of
Benjamin F. Laymon,
Bankrupt.

STIPULATION AS TO FACTS

It is hereby stipulated by and between Sherwood & Denslow Green, as attorneys for Allis-Chalmers Manufacturing Company, and Jarrett & Enmark, as attorneys for John G. Groves, the Trustee, in the above-entitled cause as follows:

1. This stipulation is entered into after submission of a motion made by Allis-Chalmers Manufacturing Company for an order establishing the priority created by a conditional sales contract and financing statement filed in the office of the County Recorder of the County of Fresno, being the County of residence of the debtor, a farmer.

2. That Benjamin F. Laymon is a bankrupt and that the proceedings in bankruptcy are pending in the above-entitled Court.

3. That Benjamin F. Laymon, at all times herein set forth, was and is a resident of the County of Fresno, and that the matters herein stipulated to were heard before Referee Charles F. Hamlin.

4. Allis-Chalmers Manufacturing Company, Farm Equipment Division, is engaged in the sale of farm equipment manufactured by Allis-Chalmers Manufacturing Company. That the Division has more than 3,000 dealers in the United States.

5. That it is the practice of the Division to have the dealers file financing statements covering farm equipment in the County of the residence of the farmer who enters into a conditional sales contract and financing statement with the dealer.

6. That the conditional sales contracts and financing statements are subsequently transferred to Allis-Chalmers Manufacturing Company, Farm Equipment Division.

7. That the Division now holds one and a half million dollars worth of papers of this type in California where the recording was made on the sale of equipment used in farming operations in the office of the County Recorder of the County where the debtor resides.

8. In this case, Mayer Equipment Co., a dealer of Allis-Chalmers Manufacturing Company at Fresno, entered into a conditional sales contract with Benja-

min F. Laymon prior to his entering into bankruptcy. The conditional sales contract and the financing statement were duly executed by Benjamin F. Laymon covering four windrowers and three farm tractors.

9. That the financing statement was timely filed in the office of the County Recorder of the County of Fresno and no issue is raised as to the form of the conditional sales contract or the financing statement or the timely filing. A financing statement was not filed with the Secretary of State.

10. That Benjamin F. Laymon was, at the time of the making of the transaction and the execution of the conditional sales contract and the financing statement, a farmer engaged in the farming of 640 acres of alfalfa on his own ranch in Fresno County.

11. That said equipment was first used on the ranch of Benjamin F. Laymon, the aforedescribed 640 acres, by the debtor in his own farming operation.

12. That subsequent to the first use, the debtor used said equipment principally as a contractor on other farms and was paid for such services by the acre. That the sales agent of Mayer Equipment Co. was informed that Benjamin F. Laymon would use said equipment on other farms as an operation where Benjamin F. Laymon furnished the equipment and the labor on contract for a stipulated price.

13. That the acreage where said equipment was subsequently used off of Benjamin F. Laymon's own farm exceeded the 640 acres farmed by Benjamin F. Laymon.

14. That Benjamin F. Laymon occasionally returned said equipment to his own farm for use thereon.

15. That Allis-Chalmers Manufacturing Company, Farm Equipment Division, duly filed a Creditor's Claim setting forth and claiming the security created by the conditional sales contract and financing statements executed by Benjamin F. Laymon covering the equipment in question.

16. That thereafter the duly appointed and acting trustee in the above-entitled bankruptcy claimed that the recording of said financing statement in Fresno County, the County of the residence of the debtor, did not create a priority over the general creditors.

17. That the trustee's claim was a conditional claim, in effect, if the ruling of Judge Crocker now on appeal in Action No. 22194 is affirmed, then the trustee will not contest the validity of the priority of the financing statement in the bankruptcy of Benjamin F. Laymon. If Judge Crocker is reversed, the ruling of the Ninth Circuit Court, if found to be applicable, will determine the priorities as between the general creditors and the claim of Allis-Chalmers Manufacturing Company for priority based on its conditional sales contract and financing statement.

In addition to the foregoing stipulated set of facts, it is further stipulated that the Referee may withhold his decision on the Motion to establish the priority of Allis-Chalmers Manufacturing Company by reason of the recording of the financing statement as herein set

forth until fifteen (15) days after the decision of the Ninth Circuit Court in Action No. 22194, and that the trustee, through his attorney, or Allis-Chalmers Manufacturing Company, through its attorneys, may present, during said fifteen (15) day period, any arguments or motions that they deem applicable by reason of the language of the decision when rendered.

Dated, April 1, 1968.

Sherwood & Denslow Green
By /s/ Sherwood Green
Sherwood Green
Attorneys for Allis-Chalmers
Manufacturing Company.

Jarrett & Enmark
By /s/ J. Roderick Jarrett
Attorneys for John G. Groves,
Trustee.

The foregoing Stipulation is hereby adopted and approved.

Dated: April 5, 1968.

Charles F. Hamlin
Referee in Bankruptcy.

NO. 22195

United States Court of Appeals

NINTH CIRCUIT

MICHAEL ARTHUR DONOVAN,

Appellant,

vs.

ROBERT G. COCKINS, City Attorney of the City of Santa Monica, and ROBERT D. OGLE, Assistant City Attorney of the City of Santa Monica,

Appellees.

Appeal from the United States District Court, Central District of California.

APPELLANT'S OPENING BRIEF

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

NO. 22195

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MICHAEL ARTHUR DONOVAN

Appellant,

vs.

ROBERT G. COCKINS, City Attorney of the City of Santa Monica, and ROBERT D. OGLE, Assistant City Attorney of the City of Santa Monica,

Appellees.

Appeal from the United States District Court, Central District of California.

APPELLANT'S OPENING BRIEF

STATEMENT OF JURISDICTION

This is a case arising under Section 1983, Title 42, United States Code, a claim of violation of civil rights protected by the U. S. Constitution committed while under color of law.

The case is a proper case for review by this Court under the provisions of Section 1291, Title 28, United States Code, since the judgment of dismissal as to Appellees is a final judgment of the District Court.

STATEMENT OF THE CASE

A. QUESTIONS PRESENTED

1) Are the City Attorney and Assistant City Attorney entitled to immunity from liability under 42 United States Code 1983, for discretionary acts done in the course and scope of their duties?

2) Does the complaint on file against Appellees state a claim on which relief can be granted?

B. MANNER OF RAISING QUESTIONS

On March 16, 1967, Appellant filed the complaint commencing on page 2 of the Record on Appeal. On April 21, 1967, Appellees filed a Notice of Motion and Motion for Summary Judgment. Said motion was granted by the HONORABLE E. AVERY CRARY, United States District Judge, on June 26, 1967, by dismissing the action against Appellees. This appeal is from that judgment of dismissal.

C. ABSTRACT OF FACTS

The facts of the case are that Appellant was employed by the City of Santa Monica as a Lifeguard up to April 6, 1963. The allegations of Appellant, plaintiff below, are that he was wrongfully discharged from such employment solely to effect punishment against him because he wrote and published newspaper articles in a local newspaper. The contents of such newspaper articles were, at times, critical, but true and fair political comment, of the City of Santa Monica and its administrators.

In April, 1964, the Personnel Board of the City of Santa Monica made findings, conclusions and recommendations:

Findings

"In 1962 and 1963 to the date of his removal, Michael A. Donovan was in the classified service of the City of Santa Monica. On April 6, 1963, he was removed from his position. On April 11, 1963, he requested a written statement of charges pursuant to Section 1110 of the Charter of the City. He never received the same, nor did the City at any time prepare any such written statement of charges."

Conclusions

"With the advice of its Attorney, the Board concludes that Section 1110 of the City Charter prohibits the appointing authority from introducing any evidence on the merits of the removal, and therefore concludes on the record before it that such removal was without just cause."

Recommendation

"That the said Donovan be reinstated."

Shortly thereafter, the next day, Appellant applied for work with the City of Santa Monica Lifeguards and was refused.

The refusal to re-employ after the determination by the Personnel Board above described was done on advice of the Appellees herein, acting under color of law in their capacities as City Attorney and Assistant City Attorney.

The internal law of the City of Santa Monica as set forth in Section 1110, Santa Monica Municipal Code, requires that a determination in favor of an employee be binding upon the City. (See copy attached to Affidavit of Robert G. Cockins contained in Record on Appeal, p. 17.)

SPECIFICATION OF ERRORS

Appellant contends that the Honorable Trial Court erred in the following particulars:

1) By concluding as a matter of law that Appellees are immune from liability under 42 United States Code 1983, as public officers performing discretionary and advisory acts within the course and scope of and in discharge of their official duties and authority as City Attorney and Assistant City Attorney.

2) By concluding as a matter of law that no claim was stated in the papers on file in the action as to defendants Cockins and Ogle, Appellees herein, under 42 United States Code 1983.

3) By entering judgment therein in favor of Cockins and Ogle.

STATEMENT OF LAW

I

"Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or of the right of the people peaceably to assemble, and to petition the government for a redress of grievances."

U.S.Constitution, First Amendment.

II

" . . . No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection

of the laws. . . ."

U.S.Constitution, Fourteenth Amendment.

III

"Every person who, under color of any statute, ordinance, regulation, custom, or usage, of the State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress."

42 U.S.C.A. 1983.

IV

Congress has power to enforce the Fourteenth Amendment of the Constitution against those who carry the badge of authority of a state and represent it in some way, whether they act *in accordance* with their authority or *misuse it.*

Monroe v. Pape, (Ill. 1961) 365 U.S. 167,
81 S.Ct. 473, 5 L.Ed. 2d 492.

Ex parte Virginia, 100 U.S. 339, 25 L.Ed. 676.

V

The acts alleged in the complaint constitute acts done "under color of law," in that they were made possible only because Appellees were clothed with the authority of the applicable law.

Beauregard v. Wingard, (D.C. Cal. 1964)
230 F. Supp. 167.

U.S. v. Classic, (1941) 313 U.S. 299,
61 S.Ct. 1031, 85 L.Ed. 1368.

VI

A determination that governmental officers acted within the scope of their employment and authority is insufficient to

defeat a claim for relief under Civil Rights Statute, since the condition imposed by the statute of the officer's acting "under color" of state or territorial law contemplates that he was in official capacity, and to the extent that such officials violate or conspire to violate constitutional and federal rights, the doctrine of immunity is abrogated.

Birnbaum v. Trussel, (C.A. N.Y. 1965)
347 F. 2d 86.

VII

The case comes up upon the Honorable District Court's granting of Appellees' Motion for Summary Judgment, and in this context factual disputes must be resolved in the manner most favorable to the party opposing the motion.

Federal Rules of Civil Procedure,
Rule 56(c), 28 U.S.C.A.
U.S. v. Diebold, Incorporated, (1962)
369 U.S. 654, 82 S.Ct. 993, 8 L.Ed. 176.

VIII

The issue of immunity from liability of public officials was posed in the case of *Beauregard v. Wingard, supra,* (D.C. Cal. 1964) 230 F. Supp. 167.

The *Beauregard* case concerned itself with action taken "under color of law" by police officers in the City of Oceanside, California. The allegations were that Plaintiff Beauregard was desirous of becoming a city councilman in Oceanside and had entered the political arena for that purpose. During his campaign, he severely criticized the Chief of Police, demanding his removal, and generally criticized the conduct of the whole Police Department; that defendants conceived a plan to force plaintiff into a compromising act or position in order to give the false appearance that plaintiff had committed a crime, cause plaintiff to be arrested,

etc.; that plaintiff was arrested without warrant, conveyed to jail, charged with bookmaking; that plaintiff was acquitted after trial; and that such action by defendants was a deprivation of plaintiff's civil rights under the Fourteenth Amendment.

The defendants raised the same defense in *Beauregard* as do Appellees in the instant case; that they are immune from liability.

The Court held in *Beauregard*:

> "We have found no authoritative case law extending any common-law immunity to police officers in Civil Rights cases, and we *hold* that immunity cannot be urged by such officers as a defense to an action under Section 1983 of Title 42 U.S.C.A." (Emphasis added. *Id.*, at 174.)

IX

A conspiracy may be the basis for a claim under 42 United States Code 1983.

Hoffman v. Halden, 268 F. 2d 280.

ARGUMENT

A. IMMUNITY

It is clear from the many cases cited that both the language and purpose of the Civil Rights Act are inconsistent with the application of common law notions of official immunity in all suits brought under the act. The test imposed by the statute, that defendants' conduct must be done "under color of any statute, ordinance, regulation . . . " (42 United States Code 1983), can rarely, if ever, be satisfied in the case of anyone other than a state official.

A holding that state officials enjoy the same immunity

under the Civil Rights Act as they might enjoy in a suit under state law would "practically constitute a judicial repeal of the Civil Rights Act." *Hoffman v. Halden, supra,* 268 F. 2d 280, 300.)

B. CAUSE OF ACTION

The trial court held that the same facts as alleged in the complaint and as indicated in the Declaration of Appellant Donovan and Affidavit of Fred Bleecker, included in the Record on Appeal, were sufficient to constitute a cause of action as to other city officials of the City of Santa Monica, in that similar motions as to them were denied by the trial court. The statute sets forth the requirements for a cause of action. The reviewing court must construe the facts as alleged and as appear in the affidavits in the most favorable manner for Appellant. These facts indicate that:

1) Appellant was employed by the City of Santa Monica;

2) That he was discharged as a result of a conspiracy between all the defendants;

3) The purpose of his discharge was to punish him for publication of newspaper articles;

4) That he was entitled to resinstatement under applicable municipal law;

5) That he was refused reinstatement after administrative determination of his right;

6) That Appellees counselled the refusal.

Should attorneys, merely because they render an opinion, be relieved of liability when that opinion is part of a plan to deprive a citizen of constitutionally guaranteed rights? The Affidavit of Fred Bleecker delineates all elements of a cause of action under the Civil Rights Act. It is not improbable that,

but for the solace afforded by an opinion of the City Attorney, the other defendants would have lacked the fortitude to so ruthlessly and summarily discharge Appellant.

CONCLUSION

Appellees should be required to defend their high-handed conduct on its merits and not be dismissed summarily without a hearing. Appellant prays for an order reversing the Judgment of Dismissal as to Appellees.

Respectfully submitted,

NEWLAN, SHAPIRO AND BAILEY

By L. A. NEWLAN, JR.

Attorneys for Appellant

CERTIFICATE

Rule 18-2(g)

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

____

Attorney

[illegible]

[illegible]

[illegible]

[illegible]

PROOF OF SERVICE BY MAIL

1013a and 2015.5 C.C.P.

STATE OF CALIFORNIA)
) ss.
County of Los Angeles)

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and employed in the County of Los Angeles, over the age of eighteen years and not a party to the within action or proceeding; that

My business address is 215 West Fifth Street, Los Angeles, California 90013, that on December 16th, 1967, I served the within APPELLANT'S OPENING BRIEF (No. 22195 – Donovan v. Cockins and Ogle) on the following named parties by depositing a copy thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States Post Office in the City of Los Angeles, California, addressed to said parties at the addresses as follows:

Robert G. Cockins, City Attorney
City of Santa Monica
and
Robert D. Ogle, Assistant City Attorney
City of Santa Monica
204 City Hall
Santa Monica, California [3 copies]

I declare under penalty of perjury that the foregoing is true and correct.

Executed on December 16th, 1967, at Los Angeles, California.

D. A. Standefer

Subscribed and sworn to before me
this day of December, 1967.

Notary Public in and for the
State of California.

Orig. & 20 copies – Clerk, United States Court of Appeals
For the Ninth Circuit
U.S. Post Office and Courthouse Bldg.
7th & Mission Sts., San Francisco 94101

DEAN-STANDEFER COMPANY, 215 W. 5th St., Los Angeles 90013

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No. 22197

In the United States Court of Appeals For the Ninth Circuit

CASCADE EMPLOYERS' ASSOCIATION, INC., CORVALLIS SAND & GRAVEL CO., EUGENE SAND & GRAVEL CO., and WILDISH SAND & GRAVEL CO.,

Petitioners,

vs.

NATIONAL LABOR RELATIONS BOARD,

Respondent.

PETITIONERS' BRIEF

On Petition to Review Decision and Order of the National Labor Relations Board

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No. 22197

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PETITIONERS' BRIEF

JURISDICTIONAL STATEMENT

This is a petition for review of a decision of the National Labor Relations Board entered March 13, 1963, and an order remanding the case to the Board for consideration of Petitioners'[1] claim that the remedy granted by the Board for the Union's unfair labor practice was inadequate because it failed to require the Union to restore to the petitioning companies sums paid under illegally-coerced collective bargaining agree-

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1. Petitioners are Corvallis Sand & Gravel Co., Eugene Sand & Gravel Co. and Wildish Sand & Gravel Co., all Oregon corporations, and Cascade Employers' Association, Inc., a nonprofit Oregon corporation (R 11-12, 93).

ments before the Board set them aside (R 84, 93). This Court has jurisdiction under 29 USC § 160(e) and (f).

STATEMENT OF THE CASE

The petitioning companies were part of a multi-employer bargaining unit which had a collective bargaining agreement with the respondent Union (Hoisting and Portable Engineers Local Union No. 701). The agreement expired on December 31, 1958, and the companies sought to bargain for a new contract through Petitioner Cascade Employers' Association, Inc. (Cascade), the successor to the unit representative which had negotiated the prior contract (R 24-25, 85).

These negotiations were followed by unfair labor practice proceedings before the Board, which found that the Union, in violation of § 8(b) (1) (B) and (3) of the Labor Management Relations Act, as amended, had restrained and coerced Corvallis, Eugene, Wildish and others in their selection of Cascade as their collective bargaining representative and had refused to bargain collectively with Cascade by seeking to break them off from the multi-employer unit which it represented (R 89).[2] It also found that by reason of the Union's pressure

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2. Section 8(b) (1) (B) makes it an unfair labor practice for a labor organization "to restrain or coerce * * * an employer in the selection of his representatives for the purposes of collective bargaining or the adjustment of grievances." Section 8(b) (3) makes it an unfair labor practice for a labor organization "to refuse to bargain collectively with an employer, * * *".

the three companies had executed individual contracts with the Union outside the bargaining unit (R 25-26).

The Board's final order directed the Union to cease and desist from the unlawful conduct, including coercion of employers represented by Cascade, and affirmatively to bargain with Cascade with respect to employees in the multi-employer unit and to post appropriate notices (R 90-91). In addition, it directed the Union to cease and desist from

> "Giving effect to the individual contracts which it executed with Corvallis, Eugene, and Wildish under the circumstances described in the original Intermediate Report, or any modification, continuation, extension, or renewal thereof." (R 90)

Thereafter, the petitioning companies commenced actions in the Oregon state court against the Union and the trustees of the Union's health and welfare and pension trust funds to whom money had been paid under the coerced agreements before the Board set them aside (R 95). The complaints alleged that the companies had paid substantial sums to the Union's members and the trustees under the contracts prior to the Board's decision setting them aside and sought restitution from the Union and the trustees of those sums.

The defendants demurred to the complaints, on the grounds that their subject matter was within the ex-

clusive jurisdiction of the Board and that they failed to state facts sufficient to constitute a cause of action. The circuit court sustained the demurrers and dismissed the complaints, and the Supreme Court of Oregon affirmed (419 P2d 38), holding that they sought a remedy for an unfair labor practice, which was a subject matter within the exclusive jurisdiction of the Board. The Court suggested that the Board could order restitution by the Union of sums paid to its members under the illegal contracts.

> "If it was the Board's belief that the 'expunging' of the union's prior unfair labor practices required the union to make restitution of the additional money *paid its members*, the Board would so have ordered. * * * The Board's failure to order restitution indicates its belief that in this instance federal labor policy did not require it."[3] (419 P2d at 43; emphasis supplied)

As to petitioners' claims against the trustees, the Court said:

> "* * * Restitution from the trustees would be as much regulation of federal labor policy concerning unfair labor practices as would restitution by the union. The trustees are third-party beneficiaries of the contract between plaintiffs and the union. If, in the opinion of the Board, federal labor policy does not require the union, which was a party to the contract, to make restitution, there is no basis for

---

3. It did not suggest that the Board could order the Union to restore money paid to the trustees.

> asserting that the trustees should be required to do so by a state court where no state law or policy is offended * * *." (419 P2d at 43)

Corvallis, Eugene and Wildish petitioned for certiorari to review the dismissal of their claims against the trustees, and represented to the Court therein that it had never before been held that such suits against third parties are pre-empted by LMRA or that the Union could be ordered to make restitution of sums paid to the trustees, and that Board orders cannot run against nonparties (such as the trustees) who are not agents of the Union or themselves guilty of unfair labor practices.[4]

On February 20, 1967 the Supreme Court entered an order requesting the Solicitor General to file a brief expressing the views of the United States (386 US 931). He did so, the brief, however, having been prepared by the Board.[5] The United States resisted the writ on the ground that reversal would recognize state jurisdiction "to supplement the remedial efforts of the National Labor Relations Board" (p 7), and that the Board

4. Petition, pp 6-8. A copy of the petition, certified by the Clerk of the United States Supreme Court, has been filed with the Clerk of this Court.

5. A copy of the Board's brief, certified by the Clerk of the United States Supreme Court, has been filed with the Clerk of this Court.

had authority to order restitution from the Union of sums paid *to the trustees.* It stated:

> "* * * the assumption that the Board was powerless is mistaken. As the court below observed, the Board could have ordered reimbursement from the Union if it had determined that the illegality involved in procuring the contracts was so pervasive that it could only be cured by restoring to petitioners the health and welfare and pension contributions paid out under the contracts * * *." (p 12)

The cases cited by the Board for its far-reaching jurisdictional claim were either inapposite or were decided long after *Sand & Gravel* and could have given petitioners no help when their case was before the Board.[6]

The petition for certiorari was denied on May 15, 1967 (____ US ____, 18 L Ed 2d 622). Thereafter, this petition was filed, asking that the case be remanded to the Board for consideration of petitioners' claim that the appropriate remedy for the unfair labor practice should extend to requiring restitution by the Union of

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6. In *Virginia Elec. & P. Co. v. N.L.R.B.*, (1943) 319 US 533 at 544 (employer required to reimburse employees for dues checked off to company-directed union) the court found that the union was the company's agent. In *Hod Carriers Union,* (1964) 150 NLRB 158 at 165-166, 181, 58 LRRM 1033, the union itself had received the money. The only decisions cited by the Board granting restitution by the Union of money paid independent third parties were decided after this case. *Plasterers Union,* (1964) 149 NLRB 1264 at 1268-1269, 57 LRRM 1448; *Plasterers' Union,* (1966) 157 NLRB 823, 61 LRRM 1447. None were cited suggesting that LMRA pre empts claims against third parties.

all or part of the sums claimed in the state court actions which it has now been held were pre-empted by LMRA.

QUESTIONS PRESENTED

1. Should the Court remand the case to the Board to determine whether petitioners should be reimbursed by the Union for sums paid by petitioners to other persons as a consequence of contracts illegally coerced by the Union in violation of §§ 8(b) (1) (B) and 8(b) (3) of the Labor Management Relations Act?

2. Is this petition barred under § 10(e) of the Act by petitioners' failure to claim such relief before the Board?

STATUTE INVOLVED

Section 10(e) and (f) of the Labor Management Relations Act of 1947 (29 USC § 160(e) and (f)) provide (in material part):

> "(e) * * * No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. * * *
>
> "(f) Any person aggrieved by a final order of the Board granting or denying in whole or in part the relief sought may obtain a review of such order in any United States court of appeals in the circuit wherein the unfair labor practice in question was alleged to have been engaged in or wherein such

> person resides or transacts business, * * *. Upon the filing of such petition, the court shall proceed in the same manner as in the case of an application by the Board under subsection (e) of this section, * * *."

SPECIFICATION OF ERROR

The Board failed to consider whether the remedy for the unfair labor practice which it found should include restitution by the Union of sums paid by the petitioning companies under the illegal contracts prior to the Board's decision, and the case should be remanded for such consideration.

SUMMARY OF ARGUMENT

The decision that petitioners' claims for restitution are pre-empted creates a grave and unanticipated injustice which the Board should have an opportunity to remedy. Under the circumstances of this case, petitioners' claims did not have to be asserted in the proceedings before the Board under § 10(e) of LMRA, and if there was such a requirement, it was excused by extraordinary circumstances present in the case. The case should be remanded to the Board for consideration of petitioners' claim.

ARGUMENT

1. Petitioners will be denied substantial relief necessary to remedy the Union's unlawful conduct if they are not permitted to raise the matter before the Board.

The Union, by unlawful coercion and in violation of §§ 8(b)(1)(B) and 8(b)(1)(3) of the Act, separated the petitioning companies from their lawful bargaining unit and forced them to accept separate contracts under which payments were made to independent trustees of the union health and welfare and pension trust funds and to the employee members of the Union. The Board prohibited the Union from giving further effect to the illegal contracts, and the companies proceeded against the Union and the trustees in state court to recover the money. Only in the course of that litigation did the Board's position emerge that the Board — and only the Board — was empowered to grant any relief, even from the trustees, who were not parties to the Board proceeding or subject to its jurisdiction.

Injuries caused by gross unlawful conduct should not go unremedied. The rapid growth of the pre-emption doctrine, and the resulting progressive unavailability of relief in more and more cases from any source except the Board, should not leave litigants without a forum in which to seek redress when it is determined for the first time that none is available in the courts.

This petition is an effort to avoid such unfairness. Petitioners cannot reopen the Board proceeding without the aid of this Court, and, of course, if that aid is given, it is not in the least certain that the Board will choose to order the Union to reimburse petitioners for the payments unlawfully extracted from them. Petitioners ask only that the Court give them an opportunity to make their claim in the only forum that — under present law — is available for redress.

2. Petitioners' claim was not waived by the failure of Cascade to assert it before the Board.

Petitioners' contention that the Board, in framing a remedy for the Union's unfair labor practice, should have awarded restitution from the Union of some or all of the sums in question, admittedly was not asserted during the administrative proceeding, in which the dominant issue was whether Cascade was the proper bargaining representative of its members. That proceeding, however, took a curious course which illustrates why it was not.

On September 8, 1960 the Trial Examiner rendered an Intermediate Report finding that the Union had violated § 8(b)(1)(B) and § 8(b)(3) of the Act and recommended that it be ordered to bargain and to cease giving effect to the individual contracts which it had coerced from the petitioning companies (R 23). On July

31, 1961 the Board reversed the Trial Examiner's findings and dismissed the complaint on the issue of Cascade's status as the bargaining representative of the unit (R 64). The General Counsel and the charging party moved for reconsideration (R 67, 69); their motions were allowed, and the case was remanded to the Trial Examiner for additional evidence "on the unit issue" (R 71). After taking additional evidence, the Trial Examiner rendered a Supplemental Intermediate Report on June 28, 1962 recommending dismissal of the complaint on the basis previously assigned by the Board (R 74). The charging party filed exceptions (R 79), and the Board in a Supplemental Decision dated March 13, 1963 reversed the Trial Examiner and held that Cascade was a proper bargaining representative and that the Union had violated § 8(b)(1)(B) and § 8(b)(3) of the Act (R 84).

From this history, it follows that the only point in the proceedings at which the present question could have been raised was during the appeal to the Board from the Trial Examiner's first decision of September, 1960. Section 10(e) of the Act does not apply to the second review proceeding, because the Trial Examiner recommended dismissal, and the question of the appropriate remedy was created only by the Board's final decision which reversed his findings. The Act does not require a petition for rehearing in such cases as a condi-

tion to consideration of petitoners' claim by this Court.

> "* * * Procedural fairness prohibits foreclosure of consideration of the question. * * *" *N.L.R.B. v. Richards*, (CA 3 1959) 265 F2d 855 at 862

Nor is Cascade's failure to raise the matter in the original appeal to the Board significant. The Board's decision to dismiss the complaint foreclosed any consideration of the appropriate remedy, including any exception relating to its scope. Furthermore, the joint propositions that relief was available through the Board from the Union, but not through the courts from those to whom the money had been paid, lay in the future (see p 6 above).

Petitioners do not seek substantive relief in this Court, but only to have the case remanded for consideration of their claim that the remedy should extend to restitutional relief. In *N.L.R.B. v. Glass*, (CA 6 1963) 317 F2d 726, an enforcement proceeding, the Board relied on § 10(e) in opposing a petition to remand for evidence justifying the discharge of an employee. No exception had been taken by the respondent to the Trial Examiner's ruling excluding the evidence. The Court held that it had discretionary power to grant the requested relief and remand for further proceedings "* * * even though objections to the Board's order were not

properly made" (317 F2d at 727). This petition is entitled to equal treatment.

3. Cascade's failure to assert these claims before the Board was the result of extraordinary circumstances, and the Court can consider the petition under § 10(e).

If § 10(e) is applicable to the case at all, extraordinary circumstances exist which account for Cascade's failure to raise the question before the Board and justify the Court's consideration of the petition. For it was only in the course of the proceedings in the Oregon courts and in the United States Supreme Court that it became established that judicial relief against independent third parties who receive money under unlawfully coerced contracts is pre-empted by LMRA, and it was only in Board cases decided long after this one that it was held that relief is available from the Union with respect to such payments (see p 6 above). This is not a case in which petitioners merely mistook their remedy — it is one in which they could not know that their choice to proceed in state court was barred — or even that the Board remedy was available to them — until long after their right to avail themselves of it had expired.

The cases support a finding of extraordinary circumstances on this record. In *N.L.R.B. v. Lundy Manufacturing Corporation,* (CA 2 1960) 286 F2d 424 the Trial Examiner found that there had been an unfair labor

practice, relying on evidence which he received on the authority of a precedent which was thereafter reversed by the Supreme Court. In a subsequent enforcement proceeding, the Board contended that under 10(e) the point was not available to the respondent, because it had not been urged before the Board. The Court said:

> "We are not persuaded by the Board's contention that respondent is precluded from seeking to avail itself of the reversal in Local Lodge because of alleged failure to urge the point before the Board, § 10(e), 29 U.S.C.A. § 160(e). Respondent consistently argued the validity of the 1957 contract; it is not fatal that respondent did not include among its arguments a specific criticism, necessarily futile at that stage, of a pertinent Board decision which had been enforced by a Court of Appeals. * * * Moreover, *even if nothing had been said*, the case would surely be one where 'the failure or neglect to urge such objection shall be excused because of extraordinary circumstances,' § 10(e), 29 U.S.C.A. § 160(e)." (286 F2d at 426; emphasis supplied)[7]

The Supreme Court has held that it is appropriate to remand in cases where circumstances arise after the Board's order which may affect the propriety of enforcing it. *NLRB v. Jones & Laughlin Steel Corporation*, (1947) 331 US 416 at 427. The same principle is applicable to this case.

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7. See also *Saratoga Harness R. Ass'n v. New York State L. R. Bd.*, (1958) 177 NYS 2d 401 at 403, 6 AD 2d 329, aff'd (1959) 6 NY 2d 960, 191 NYS 2d 161, 161 NE 2d 388.

Finally, the unusual course of the proceedings below and the parties' pre-occupation with the operation of the bargaining unit understandably clouded the question of the scope of the remedy. In *National Labor Relations Board v. Spiewak*, (CA 3 1949) 179 F2d 695 at 701-702 the Board objected to the sufficiency of an employer's exceptions to raise the question of its reasons for a refusal to re-employ. The Court held that if the exceptions were insufficient, the circumstances fell within the exception § 10(e):

> "* * * The Spiewak reasons for denying re-employment to the six were developed on the Board's own cross-examination. *The full significance of that testimony was apparently lost sight of by both sides in the dispute over whether the employer could rely on the 1944 contract for the refusal to take back the six.* They failed to see the trees for the forest. The fact that respondents did not rehire the six because of employee opposition is vital to this branch of the litigation, and, in fairness to all concerned, cannot be disregarded." (179 F2d at 702; (emphasis supplied)[8]

4. The Court should remand the case to the Board.

The Court should exercise its discretion to remand the case to the Board to consider petitioners' claim. The Board's decision established that the contracts under

8. See also *International Ladies' Garment Workers' Union v. N.L.R.B.*, (1964) 339 F2d 116 at 121: § 10(e) inapplicable because the failure to except was not a part of a "deliberate strategy" and did not prejudice the Board's case.

which the money was paid were illegally coerced by the respondent Union. So far as petitioners were concerned —and very likely so far as the Act is concerned, as well —barring their further performance was only part of a remedy. The petitioning companies paid money under the contracts which it now develops cannot be recovered in judicial proceedings from those to whom it was paid. The Board should at least address itself to the question whether additional relief is desirable to remove the effects of the unfair labor practice.

In the Board's brief filed with the United States Supreme Court, it suggested considerations which might lead it to deny such relief. There are others which suggest a contrary conclusion: The obvious unfairness of protecting payments to third persons under contracts which have been illegally coerced; the danger of promoting contract provisions calling for initial balloon payments to third persons; and the history of intransigence and illegal conduct of this Union.

We cannot, of course, anticipate the Board's decision. The present question is whether the Court should remand the case so that the Board can make one. The Board's expertise should be brought to bear on a problem created by its assertion of a new and expanded jurisdiction, and as to which those subject to its jurisdiction require instruction. See *Burinskas v. N.L.R.B.*, (CA DC 1966) 357 F2d 822 at 827.

CONCLUSION

The petition for review should be granted, and the case should be remanded to the Board to consider petitioners' claim.

Respectfully submitted,

McCOLLOCH, DEZENDORF & SPEARS

JAMES H. CLARKE

LEWIS K. SCOTT

Attorneys for Petitioners

CERTIFICATE

I certify that, in connection with the preparation of the foregoing brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

____

Attorney

NO. 22197

In the
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Petitioners,

vs.

NATIONAL LABOR RELATIONS BOARD,

Respondent,

and

HOISTING AND PORTABLE ENGINEERS LOCAL UNION NO. 701,

Intervenor-Respondent.

BRIEF OF INTERVENOR-RESPONDENT, HOISTING AND PORTABLE ENGINEERS LOCAL UNION NO. 701

On Petition to Review Decision and Order of the National Labor Relations Board

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JURISDICTIONAL STATEMENT

Petitioners rely upon 29 USC 160 (f) to support the jurisdiction of this Court. The National Labor Relations Board, original Respondent herein, admits the jurisdiction of this Court (Answer, par. 1). The Intervenor-Respondent, by its answer, admits the jurisdictional allegations of the Petitioner (par. 1 of Answer).

However, the Petition to review and modify an order of the National Labor Relations Board, hereinafter the Board, which was made on March 13, 1963, was not filed in this Court until more than four years thereafter, on September 19, 1967. These facts alone pose a serious question whether this Court should decline, in its discretion, to exercise a conceded jurisdiction thus tardily invoked.

SUPPLEMENTAL STATEMENT OF THE CASE

Intervenor-Respondent, hereinafter the Union, accepts the Statement of the Case made in Petitioners' Brief (pp. 2-7) insofar as the Statement confines itself to facts. The inferences from facts and the legal consequences of those facts are contested.

Both the Board and the Union seek this Court's dismissal of the Petition to review and modify, and for

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essentially the same reasons. As original Respondent in the Board case, any practical consequences of a re-opening of this aged controversy will adversely affect the Union.

The individual companies Petitioners before this Court would be the immediate financial beneficiaries of any "restitution" order the Board might make, if it be assumed that on remand from this Court the Board should reverse itself and conclude that the affirmative action of "restitution" would be a practical and necessary effectuation of the policies of the National Labor Relations Act. Those companies were the parties plaintiff in the Oregon state court proceedings. The Union was a party defendant. The judgment of the Supreme Court of Oregon, affirming the trial court's dismissal on demurrers, stands effective as between those individual Petitioners and the Union. Among the findings and conclusions expressed in the Opinion of the Supreme Court of Oregon (419 P2d 38) are the following:

> "The determination of the relief to which a party to a collective bargaining agreement may be entitled, where the agreement was obtained by unfair labor practices, is sufficiently important in the regulatory process as to be within the sole province of the Board..."
>
> (419 P2d at 42)

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> "If it was the Board's belief that the "expunging" of the union's prior unfair labor practices required the union to make restitution of the additional money paid its members, the Board would have so ordered..."
>
> (Emphasis supplied. 419 P2d at 43)

*****

> "...The restitution of money paid as a result of a contract entered into because of unfair labor practices would certainly come within '***such affirmative action***as will effectuate the policies of /the National Labor Relations Act/***' ****The Board's failure to order restitution indicates its belief that in this instance federal labor policy did not require it."
>
> (Emphasis supplied. 419 P2d at 43)

The Oregon litigation involved an issue raised by the demurrers which was not passed upon by the Supreme Court of Oregon. One ground of demurrer was "that the complaint did not state a cause of suit because it showed plaintiffs sought, obtained and accepted relief from the Board without asking for the relief sought by the present suits." (419 P2d at 41) The Supreme Court disposed of the case on the preemption issue and did not reach the question whether Petitioners were precluded from seeking restitution because of their failure to request that relief from the Board, Petitioners' Brief concedes this failure(pp.10-13)

ADDITIONAL QUESTIONS PRESENTED

1. Are the individual Petitioners barred from the relief they request from this Court by the Oregon adjudication against them, and in favor of Intervenor-Respondent?

2. Is Cascade, as a representative for purposes of collective bargaining of the individual Petitioners, barred from the relief requested from this Court by the doctrine of collateral estoppel by judgment of the Oregon Supreme Court?

SUMMARY OF ARGUMENT

1. The Union stands in substantially the position of the Board in respect to the issues raised by the Petition and the Board's Answer involving (a) the failure of Petitioners to request of the Board the relief for which remand is sought, and (b) the suitability of the relief sought tested by its effectuation of the public policies of the National Labor Relations Act, particularly so long after the unfair labor practices and the Board's closing of the case. This Brief will therefore adopt the substance of the Board's contentions on those issues, without burdening this Court with another version of the argument against the Petition on those issues.

2. The Oregon Supreme Court's findings and conclusions, quoted in the Supplemental Statement of

the Case (pp. 2,3,infra), and its judgment based thereon, are final and binding as to those Petitioners' claims against the Union for "restitution." The individual Petitioners failed to request Certiorari as against the Union. They can neither attack the Oregon judgment nor relitigate in this Court and before the Board the findings and conclusions of the Oregon Court.

3. The Association, hereinafter Cascade, is merely a collective bargaining representative of the individual Petitioners, and it is thus barred by the Oregon judgment, and the findings and conclusions upon which that judgment is founded, because Cascade is in privity withthe individual Petitioners. In any event, Cascade is only an agent for the individual Petitioners in seeking a remedy which would eventuate in "restitution" to the sand and gravel operators, and the equitable doctrine of collateral estoppel by judgment applies to bar Cascade's Petition.

ARGUMENT

I.

<u>The Individual Companies Petitioner are Barred From the Relief They Ultimately Seek Against the Union by the Judgment of the Oregon Supreme Court.</u>

The immediate relief sought by the Petition is that this Court should remand this case to the Board.

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[illegible]

[illegible]

[illegible]

[illegible]

But the Petition (p. 5) asks a direction that the Board thereupon "decide if petitioners are entitled to restitution against the Union as an additional remedy for the unfair labor practices which it found."

These individual sand and gravel companies sought precisely that relief against the Union in their Oregon complaints (419 P2d 39-"The relief sought is rescission of the agreements, restitution of the sums paid thereunder,..."). The final judgment of the Oregon Supreme Court is determinative of their right to "restitution" despite their now seeking that remedy in another forum or forums. Southern Pacific R. Co. v. United States, 168 U.S. 1, 48,49, 18 S. Ct. 1827, 42 L ed 355, 377; United States v. Munsingwear, 340 U.S. 36, 71 S. Ct.104, 95 L ed 36.

This case concerns unfair labor practices which took place from May to August 1959. The Board decision and order, with which the Union complied, was dated March 13, 1963. The Oregon trial court judgment against the individual Petitioners and in favor of the Union was entered September 9, 1965. The Supreme Court of Oregon rendered its Opinion on October 12, 1966. The instant Petition was filed September 19, 1967. "The case illustrates not the hardship of res judicata but the need for it in providing terminal points for Litigation." Mr. Justice Douglas in Munsingwear, supra,p.41.

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[illegible]

II.

The Findings and Conclusions of the Oregon Supreme Court are Likewise Binding Against the Individual Petitioners. By Finding That Specific Affirmative Actions, Coupled With Compliance With Cease And Desist Requirements, Would Effectuate the Policies of the Act, the Board Determined That Those Policies Did Not Require "Restitution." The Oregon Supreme Court Supported That Determination.

The requirements of the Board's Order against the Union are adequately summarized on page 3 of Petitioners' Brief. Subsequent to the Order the three sand and gravel operators commenced their Oregon litigation. The complaints were bottomed upon the Board's findings of unfair labor practices (419 P2d 40). The Board had concluded in its Decision and Order that the requirements of the Order would effectuate the policies of the National Labor Relations Act.

With the Board's Decision and Order before it, the Supreme Court of Oregon explicitly concluded that if the Board believed "restitution" necessary to the public policy it enforces "the Board would have so ordered." The Court also specifically found that: "The Board's failure to order restitution indicates its belief that in this instance federal labor policy did not require it."

These findings and conclusions were points on which that Court [illegible] to pronounce judgment and points which [illegible] belonged to the subject of the contro[illegible]

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which the parties presented and points on which the Court found itself required to prombunce judgment. Woods v. Cannady, 158 F2d 184. These facts, thus established in the earlier litigation, are conclusively established in this subsequent proceedings between the parties. The Evergreens v. Nunan, 141 F 2d 927, cert. den. 323 U.S. 720, 65 S. Ct. 49, 89 L ed 579; Alexander v. C.I.R., 224 F 2d 788. These rights, facts and matters at issue were both necessarily involved and directly adjudicated on their merits by the highest Oregon tribunal. They cannot again be litigated between the same parties, even though the precise subject matter of the litigation now pending is not the same. The ultimate purpose is the same, and the findings and conclusions relied upon by the Union would necessarily be ignored if that purpose is to be achieved. Re California Lumber Corp., 227 F Supp 63; Gaitan v. U.S., 295 F2d 277, cert. den. 369 U.S. 857, 82 S. Ct. 939, 8 L ed2d 15.

III.

Cascade is a Corporate Association, "Representative" of the Individual Company Petitioners, Bound by the Oregon Findings, Conclusions and Judgments.

Cascade filed the original charges of unfair labor practices as representative of Eugene, Corvallis and Wildish Sand and Gravel Companies. These three firms

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would be the ultimate and direct beneficiaries of any ultimate order of "restitution" which the Board might enter. The incidental fact that Cascade is now a Petitioner in this Court of Appeals proceeding should not dilute the effect of the previous adjudication against the remedy of "restitution. It is plain that Cascade is equally barred with the individual Petitioners, whether upon the strict doctrine of privity or because of collateral estoppel by judgment.

Cascade, as the agent of the individual Petitioners cannot have any greater right to attack the Union before this Court than the individual Petitioners have. The principals being barred from asserting their claim to the relief of "restitution", their agent cannot press that claim on their behalf.

CONCLUSION

For the reasons expressed in this Brief, as well as those reasons urged by the Board's Brief, and adopted in substance by the Union, the Petition should be dismissed. At this point Petitioners' stale claim for "restitution" deserves judicial burial.

Respectfully submitted,

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<ins>CERTIFICATE OF COUNSEL</ins>

I, Clifford D. O'Brien, Attorney for the Intervenor-Respondent herein, hereby certify that in connection with the preparation of the foregoing Brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

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No. 22,197

nited States Court of Appeals

FOR THE NINTH CIRCUIT

CASCADE EMPLOYERS' ASSOCIATION, INC.,
CORVALLIS SAND & GRAVEL CO.,
EUGENE SAND & GRAVEL CO.,
and
WILDISH SAND & GRAVEL CO.,
Petitioners,

v.

NATIONAL LABOR RELATIONS BOARD,
Respondent.

On Petition To Review and Modify an Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

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AUTHORITIES CITED

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FOR THE NINTH CIRCUIT

No. 22,197

CASCADE EMPLOYERS' ASSOCIATION, INC.,
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and
WILDISH SAND & GRAVEL CO.,
Petitioners,

v.

NATIONAL LABOR RELATIONS BOARD,
Respondent.

On Petition To Review and Modify an Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court upon the petition of Cascade Employers' Association, Inc. (hereinafter referred to as "Cascade"), Corvallis Sand & Gravel Co., Eugene Sand & Gravel Co.,

and Wildish Sand & Gravel Co. (hereinafter referred to as "the Companies") to review and modify an order of the National Labor Relations Board (R. 93-97).[1] The Board's Decision and Order issued on March 13, 1963, pursuant to Section 10(c) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 151, *et seq.*) and are reported at 141 NLRB 469. This Court has jurisdiction of the proceeding under Section 10(f) of the Act, the unfair labor practices having occurred in and around Portland, Oregon, within this judicial circuit.

COUNTERSTATEMENT OF THE CASE

I. PROCEEDINGS BEFORE THE BOARD; CASCADE FAILS TO REQUEST A REIMBURSEMENT ORDER

Petitioners herein are the bargaining agent of a multi-employer bargaining unit (hereafter referred to as Cascade), and three of the employers who are members of that unit (hereafter referred to as the Companies). Cascade had a collective bargaining contract with the Hoisting and Portable Engineers Local Union No. 701 (hereafter referred to as the Union). When this contract expired on December 31, 1958, the members of the multi-employer unit sought to bargain for new contract terms with the Union through their bargaining representative, Cascade. The conduct of these negotiations gave rise to unfair labor practice proceedings before the Board.

On August 12, 1959, Cascade, on behalf of its members, filed unfair labor practice charges alleging that the Union had refused to bargain collectively with it as the representative of the established multi-employer unit and that it had restrained and coerced the Companies in their selection of a bargaining representative. Cascade and the Companies were parties to the ensuing unfair labor practice proceeding.

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[1] "R" references are to pages of Volume I of the record as reproduced according to Rule 10 of the Rules of this Court. References designated "Tr." are to the reporter's Transcript of the testimony as reproduced in Volume II of the record.

On September 8, 1960, subsequent to a hearing, the Trial Examiner issued his Intermediate Report, finding that the Union had violated its statutory duty by refusing to bargain with Cascade, and by coercing the Companies into signing separate contracts with it. He recommended that the Union cease and desist from its refusal to bargain and from giving effect to the individual contracts executed with the Companies (R. 30, 31). The Trial Examiner made no recommendation that the Union reimburse the Companies for any monies paid into its health and welfare funds pursuant to the contracts, or for any additional wages paid pursuant to these contracts. Neither Cascade nor the Companies had asked the Trial Examiner to recommend a reimbursement order. Cascade did not except to any of the Trial Examiner's findings, nor did it ask the Board to enlarge upon his recommended remedial order. Indeed, Cascade filed a brief in support of the Trial Examiner's Intermediate Report and Recommended Order.

On July 31, 1961, the Board reversed the Trial Examiner's findings of violation of the Act on the ground that Cascade was not the historically established multi-employer unit, and that, consequently, the Union was not obliged to bargain with Cascade (R. 64-66). Thereafter, both the General Counsel and Cascade filed motions for reconsideration of the Board's Decision. The Board granted the motions and ordered further hearings for the purpose of receiving evidence on the multi-employer unit issue, "including whether or not Cascade was attempting to bargain for the historically established multi-employer bargaining unit" (R. 71).

On June 28, 1962, the Trial Examiner issued his Supplemental Intermediate Report, recommending that the Board reaffirm its earlier dismissal of the case (R. 74-78). Cascade filed timely Exceptions to the Trial Examiner's Supplemental Report (R. 79-82). Cascade excepted to the Trial Examimer's failure to find that the Union had illegally refused to bargain and coercively obtained individual contracts. However, its exceptions and supporting brief again made no mention of a failure to order reimbursement of funds.

II. THE BOARD'S CONCLUSION AND ORDER

In its Supplemental Decision and Order, issued on March 13, 1963 (R. 84-91), the Board found that the Union had violated Section 8(b) (1) (B) and (3) of the National Labor Relations Act, by restraining and coercing the Companies in their selection of Cascade as their bargaining representative in a historically established multi-employer unit. and by refusing to bargain with Cascade. The Board further found that the Union's pressure had succeeded in forcing the petitioning Companies to execute individual bargaining agreements with the Union and ordered the Union to cease and desist from restraining or coercing any employer represented by Cascade in the selection of Cascade as its representative for collective bargaining purposes, from refusing to bargain collectively with Cascade with respect to employees in the appropriate bargaining unit, and from giving effect to the individual contracts executed with the Companies. Affirmatively, the Board ordered the Union to bargain with Cascade and to post appropriate notices.

In June of 1963 the case before the Board was closed, the Union having satisfactorily complied with the affirmative requirements of the Board's order.

III. THE SUBSEQUENT STATE COURT LITIGATION

Two years later, on June 8, 1965, the Companies filed complaints in the Circuit Court, Multnomah County, Oregon, against the Union, its officers, and the trustees of the Union's health and welfare and pension funds. Based on the Board's finding that the individual contracts were unlawfully procured, the complaints sought rescission and restitution from the Union and the Trustees of sums paid thereunder. The Companies sought to recover from the Union the additional wages paid thereunder to Union members; and from the health and welfare trustees and pension trustees the sums paid to their respective funds for the benefit of members of the Union. The defendants filed demurrers on the ground that state court jurisdiction over the subject matter was pre-empted by the Labor Management

Relations Act and that the complaints did not state a cause of action because they showed plaintiffs sought, obtained and accepted relief from the Board without asking for the relief sought in the state court suits. The Circuit Court sustained the demurrers and dismissed the actions.

On appeal, the Oregon Supreme Court affirmed the trial court, holding that the Companies' claims for rescission of the contracts and restitution of the monies paid thereunder rested solely on the ground that the contracts were procured through the unfair labor practices of the Union, and that "there is no state right which the court is requested to vindicate." *Corvallis Sand & Gravel Co. v. Hoisting & Portable Eng.*, 419 P.2d 38, 42 (1966). Accordingly, the court concluded that the fashioning of a remedy for the wrong that was the gravamen of the complaints was within the exclusive province of the Board, and that the state court was thus without jurisdiction of the suits.

Subsequent to this ruling, the Companies petitioned the United States Supreme Court to review the state court's pre-emption ruling.[2] The Companies contended that the Board lacked power to order reimbursement by the trustees and that the Oregon suit was, therefore, not pre-empted. At the invitation of the Supreme Court (386 U.S. 931), the Solicitor General submitted a memorandum expressing the views of the United States. In that memorandum, a copy of which has been lodged with the Court by petitioners, it was urged, on the authority of *San Diego Bldg. Trades Council v. Garmon,* 359 U.S. 236, that the suit was pre-empted whether or not the Board had the power to grant the remedy requested.[3] The memorandum further urged that the Board did have the power

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[2] The Companies sought review of the ruling that the suits against the trustees were pre-empted, but did not seek review of the holding that their suits against the Union for payments into the health and welfare funds were pre-empted.

[3] In *Garmon,* the Supreme Court had stated, 359 U.S. at 247: "It may be that an award of damages in a particular situation will not, in fact, conflict with the active assertion of federal authority. The same may be true of the incidence of a particular state injunc-

(Continued)

the Companies urged it lacked, but that whether or not this particular remedy should be granted in any given case was dependent upon the particular circumstances. The memorandum also pointed out that the Board had not been asked to order reimbursement in the underlying unfair labor practice proceeding:

> "Had the issue of recoupment been presented to the Board, it might have concluded that it would be too speculative to attempt to determine the difference between the terms that were negotiated individually and those that might have been negotiated through Cascade; or it might have concluded that a reimbursement order would be excessive for the violations found, or that to impose such a remedy would not be conducive to satisfactory bargaining relations between the parties in the future. Had the Board so ruled, it seems clear that the principles of *Garmon, supra,* would have barred any effort to recoup the benefits in a State court suit brought against the Union, the trustees, or both. Petitioners should not be in any better position merely because they failed to present the issue of recoupment to the Board." (Memorandum for the United States in No. 891, October Term, 1966, pp. 9-10)

On May 15, 1967, the Supreme Court denied the petition for a writ of certiorari. 387 U.S. 904.

SUMMARY OF ARGUMENT

Petitioners concede that they never asked the Board to grant the remedy they now urge it was error for the Board to

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[3](Continued)
tion. To sanction either involves a conflict with federal policy in that it involves allowing two law-making sources to govern. In fact, since remedies form an ingredient of any integrated scheme of regulation, to allow the State to grant a remedy here which has been withheld from the National Labor Relations Board only accentuates the danger of conflict."

omit. In these circumstances, Section 10(e) of the Act, which provides that no objection not raised before the Board may be raised before the reviewing court, precludes litigation of the alleged error. Petitioners' contention that extraordinary circumstances excuse their failure to object is erroneous. Even assuming that the Board's power to grant the remedy now requested was not clear at the time the instant proceeding was litigated before the Board, there is no justification for the failure to ask the Board to grant the remedy. Had petitioners done so, they would thereby have precipitated litigation which would have clarified the matter. In these circumstances, the Board should not be required to reopen this record and give retroactive application to a subsequent expansion of its remedial powers. To impose such a requirement on the Board would cause an unwarranted disruption of the administration of the Act.

ARGUMENT

SECTION 10(e) OF THE ACT PRECLUDES LITIGATION OF PETITIONERS' CONTENTION THAT THE BOARD ERRONEOUSLY FAILED TO CONSIDER THE PROPRIETY OF A REIMBURSEMENT ORDER

More than four years since the instant proceeding was closed upon compliance with the Board's order, petitioners request this Court to remand the case with direction that the Board consider their claim that the remedial order should have included a provision requiring restitution of sums paid pursuant to individual contracts found to have been illegally obtained. Aside from the staleness of their claim, petitioners must acknowledge that at no time in the litigation of this matter before the Board did they ever ask the Board to grant the remedy they now seek.

In such circumstances, Section 10(e) of the Act clearly provides that "[n]o objection that has not been urged before the Board, its member, agent or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances." This statutory provision gives expression

to "the policy which requires that the Board's expert judgment should be brought into play by a dissatisfied litigant before recourse is had to the Courts." *N.L.R.B. v. Int'l Union of Operating Engineers, Local 66,* 357 F.2d 841, 847 (C.A. 3). Where, as here, the propriety of a proposed remedial measure is involved, it is especially important that the Board's expertise be brought into play because "the relation of remedy to policy is peculiarly a matter for administrative competence . . . ." *N.L.R.B. v. Phelps Dodge Corp.,* 313 U.S. 177, 194. Accordingly, the Supreme Court has consistently ruled that unless the Board has "patently traveled outside the orbit of its authority," *N.L.R.B. v. Cheney California Lumber Co.,* 327 U.S. 385, 388, Section 10(e) preludes judicial consideration of objections to a remedial order which were not raised in the administrative proceeding. *N.L.R.B. v. Ochoa Fertilizer Corp.,* 368 U.S. 318, 322; *N.L.R.B. v. Local 476, United Assoc. of Journeymen etc.,* 368 U.S. 401; *N.L.R.B. v. Seven-Up Bottling Co.,* 344 U.S. 344, 350; *Marshall Field & Co. v. N.L.R.B.,* 318 U.S. 253, 256; *May Dept. Stores Co. v. N.L.R.B.,* 326 U.S. 376, 387.

The propriety of a recoupment order in this case "admittedly was not asserted during the administrative proceeding. . ." (Petitioners' Br., p. 10).[4] Accordingly, unless "extraordinary circumstances" excuse this failure, petitioners

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[4] Similarly, petitioners admit that they had an opportunity to raise this remedial issue during the administrative proceeding. Thus, petitioners concede (Br., p. 11) that they could have objected to the Trial Examiner's initial decision in which he recommended remedial provisionsto the Board but made no mention of recoupment of sums paid under the individual contracts. As pointed out in the Counterstatement, *supra,* p. 3 , far from objecting to the Trial Examiner's rulings, petitioners filed a brief in support of the Trial Examiner's Intermediate Report and Recommended Order.

There is little need to comment at length on petitioners' contention that this was "the only point" at which it could have raised the recoupment issue before the Board and that it did not have a second chance when it filed objections to the Trial Examiner's second decision recommending dismissal of the complaint because "the question of the appropriate remedy was created only by the Board's final decision which reversed his findings" (Br., p. 11). First, there was nothing to preclude respondent from including a request for a recoupment

are precluded from urging that the Board erroneously failed to consider the propriety of a restitution order.[5] Petitioners' contend that "extraordinary circumstances" exist by virtue of the fact that it was only when it lost its suit in the Oregon courts that it became established that the preemption doctrine precluded recoupment in a state court proceeding and that it was only in Board cases decided subsequent to the close of the instant Board proceeding that it became clear that the Board had the power to grant the recoupment remedy it now seeks. We submit that petitioners have not made out a case of "extraordinary circumstances" within the meaning of Section 10(e).

In essence, petitioners' argument is that whenever the Board grants a remedy which it may not have previously ordered, any charging party in any prior Board proceeding may ask an appellate tribunal to direct the Board to reopen his case. Presumably, this principle would apply even where, as here, a case has long since been closed on compliance and the charging party had never asked the Board for the remedy it now requests because it erroneously believed the Board to be without power to issue it. Retroactive application is not even uniformly granted in the criminal law despite the fact that subsequent legal precedents have established that the defendant suffered substantial deprivation of constitutional rights. See, *Johnson v. New Jersey*, 384 U.S. 719. *A fortiori*, retroactive application is not required in an administrative proceeding of this nature. Certainly, subsequent precedent should not be grounds for excusing a failure to present a contention to the Board. Indeed, this Court has so held. In *N.L.R.B. v. Pinkerton's Nat'l Detective Agency*, 202 F.2d 230, 233, this Court had occasion to examine and reject the very contention petitioner urges here. In that case, the parties had not challenged before

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[4] (Continued)
remedy in its objections to the Trial Examiner's recommendation that the complaint be dismissed. Second, even if petitioners could reasonably have thought they were precluded from doing so, the principle that administrative remedies must be exhausted applies so long as the litigant has had an opportunity to present his arguments to the agency. He need not be afforded a second opportunity.

[5] See "Specification of Error" at Petitioners' Br., p. 8.

the Board the ruling that a union security clause was invalid. While the case was pending on appeal on other issues, this Court handed down another opinion which, if applied to the pending appeal, might require a determination that the union security clause was valid. This Court ruled that Section 10(e) applied and that the validity of the contract clause could not be raised despite the subsequent legal precedent. 202 F.2d at 232-233. The Court rejected the contention that "extraordinary circumstances" were presented (202 F.2d at 233):

> "While Section 10(e) quoted above makes an exception of cases involving 'extraordinary circumstances', the fact that our decision in the *Insulators* case was handed down shortly before the oral argument in this court cannot be regarded as such an extraordinary circumstance. We note what was said in *Sunal v. Large,* 332 U.S. 174, 182, 67 S. Ct. 1588, 91 L. Ed. 1982. There a somewhat similar hardship situation arose in a criminal case because a new, and unexpected but controlling decision had been announced after time for appeal had expired. The same reasons there given why the court declined to treat that circumstance as sufficiently extraordinary to warrant habeas corpus, apply here. Hence, a remand to the Board for consideration of a new objection or new evidence would not be appropriate. *N.L.R.B. v. Mexia Textile Mills,* 339 U.S. 563, 569."[6]

Moreover, the argument that counsel was unaware that state courts lacked jurisdiction to augment Board remedial powers or that the Board lacked power to grant a recoupment remedy of the nature now sought is not persuasive.

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[6] See also, *Wheeler v. N.L.R.B.,* 382 F.2d 172, 175 (C.A.D.C.) wherein the Court refused to disturb a Board decision not to hold a purchaser of an enterprise liable for unfair labor practices of the predecessor in the light of a subsequent Board decision announcing a new rule of successorship liability. And, there, unlike the case at bar, the litigant had urged the successorship issue at every appropriate stage of the administrative proceeding.

San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236, was decided on April 20, 1959, prior to the commencement of the instant unfair labor practice proceeding. The Supreme Court there made it crystal clear that the preemption doctrine precluded a state court from remedying conduct which constituted an unfair labor practice, whether or not the power to issue the remedial measure sought had been withheld from the Board. See, *supra,* p. 5, n.3. Thus, there was ample reason to anticipate that if recoupment was to be obtained it would have to be requested from the Board. Moreover, whether or not the Board had previously granted reimbursement in the precise circumstances here presented, should not excuse petitioners' failure to present the issue to the Board. The Board had never ruled that it lacked power to grant this remedy and both the relevant statutory provision and the case law strongly indicated that the Board possessed ample power to require reimbursement where the circumstances warranted it. Section 10(c) of the Act provides that where the Board finds that an unfair labor practice has been committed, it "shall issue . . . an order requiring such person to cease and desist from such unfair labor practice, and to take such affirmative action including reinstatement of employees with or without backpay, as will effectuate the policies of this Act . . ." This grant of remedial power has been interpreted broadly by the Supreme Court almost since the Wagner Act became law. See, e.g., *N.L.R.B. v. Pennsylvania Greyhound Lines, Inc.,* 303 U.S. 261, 262 (Section 10(c) of the Act "leave[s] to the Board some scope for the exercise of judgment and discretion in determining, upon the basis of the findings, whether the case is one requiring an affirmative order, and in choosing the particular affirmative relief to be ordered."); *I.A.M. v. N.L.R.B.,* 311 U.S. 72, 82 ("It is for the Board, not the courts, to determine how the effect of prior unfair labor practices may be expunged."); *N.L.R.B. v. Phelps Dodge Corp.,* 313 U.S. 177, 194 ("The Act does not create rights for individuals which must be vindicated according to a rigid scheme for remedies. It entrusts to an expert agency the maintenance and promotion of industrial peace."); *N.L.R.B. v. Seven-Up Bottling Co.,* 344 U.S.

344, 351 (The Board has "the discretionary power to mould remedies suited to practical needs. . . ."). And, the Supreme Court long ago sanctioned a reimbursement remedy similar to that sought here. *Virginia Electric & Power Co. v. N.L.R.B.*, 319 U.S. 533. In this 1943 decision, the Court held that where an employer assists and dominates a labor organization, the Board has power to require him to reimburse employees for dues which he checked off and paid to that organization. The Court ruled that the Board

> "is not limited to the illustrative example of one type of permissible affirmative order [set forth in Section 10(c)], namely, reinstatement with or without backpay. . . Here the Board, in the exercise of its informed discretion, has expressly determined that reimbursement in full of the check-off dues is necessary to effectuate the policies of the Act. We give considerable weight to that administrative determination. It should stand unless it can be shown that the order is a patent attempt to achieve ends other than those which can fairly be said to effectuate the policies of the Act." 319 U.S. at 539-540.

The issue here is not whether *Virginia Electric* can be distinguished from the remedy sought here (see Petitioners' Br., p. 6, n. 6). Rather, the point is that in light of the numerous cases, including *Virginia Electric, supra,* in which the Board's remedial powers have been acknowledged to be exceedingly broad, the failure to ask the Board for the recoupment remedy should not be excused because petitioners "could not know" (Br. p. 13) that this remedy was available to them. The short answer is, they should have asked.

In the final analysis, this appeal represents nothing more than a belated attempt to cure a litigation error. The law is well-settled that such an error does not constitute extraordinary circumstances. *Smith v. Stone,* 308 F.2d 15, 18 (C.A. 9); *Flett v. W. A. Alexander & Co.,* 302 F.2d 321, 324 (C.A. 7); *N.L.R.B. v. Izzi,* 343 F.2d 753, 755 (C. A 1). It is plain

that unless the Board is able to enforce its requirement that exceptions be filed which are both timely and specific, those requirements will be totally without meaning. Parties would be free to augment their positions, at their convenience, long after a case has been closed. In proceedings before the Board—as before any other tribunal—the failure of counsel to vigorously pursue the avenues available to him at the appropriate time must be imputed to the litigant. "Chaos would result" if any other rule were followed. *Smith v. Stone, supra,* 208 F.2d at 18. Indeed, "there would be no end of Board matters if such patent disregard of the rules must be forgiven as a matter of law . . . ." *N.L.R.B. v. Izzi, supra,* 343 F.2d at 755. It is possible that the failure to raise the recoupment issue before the Board has resulted in some loss to petitioners. However, to require the Board to reopen every case in which such a possibility could be shown would be to cast a heavy burden upon it. Petitioners' "protestations that this particular case should be revived in the interests of justice . . . overlooks how justice in the large would suffer were laxness of this sort excusable as matter of law." *Izzi, supra,* 343 F. 2d at 755. As stated by the Supreme Court in *U.S. v. Tucker Truck Lines,* 344 U.S. 33, 36-37:

> "Simple fairness to those who are engaged in the task of administration, and to litigants, requires . . . that courts should not topple over administrative decisions unless the administrative body not only has erred but has erred against objection made at the time appropriate under its practice."

The cases relied upon by petitioners are wide of the mark. In *N.L.R.B. v. Glass,* 317 F. 2d 726 (C.A. 6) the respondent sought to raise an issue which the Board conceded was litigable at the compliance stage of proceedings. The Court ruled that there was no reason "why we should not act now rather than later." Here, much more is involved than when an issue is properly litigated. The issue here is whether judicial review is entirely precluded.

In *N.L.R.B. v. Lundy Mfg. Corp.*, 286 F.2d 424, 426 (C.A. 2), the Court permitted the respondent to argue the effect of an intervening Supreme Court decision on the Board's determination that a contract was invalid. The Court pointed out that the respondent had "consistently argued" the validity of the contract to the Board, and that "it is not fatal that respondent did not include among its arguments a specific criticism, necessarily futile at that stage, of a pertinent Board decision which had been enforced by a Court of Appeals." The Court also added that the intervening Supreme Court decision constituted extraordinary circumstances which would excuse respondent's failure to add the particular subsidiary point to its general argument that the contract was valid. Whether or not the Court was right,[7] the case at bar is wholly distinguishable. Here, there was no Board case holding that the recoupment remedy now sought could not be granted, no intervening Supreme Court decision reversing the Board on the point and further, petitioners made no issue of the recoupment remedy before the Board.

In *N.L.R.B. v. Spiewak,* 179 F.2d 695, 701-702 (C.A. 3), the employer had put forth two reasons for refusing to rehire six strikers. The Trial Examiner mentioned only one of these reasons and found it an insufficient defense to the charged unfair labor practice. Although the employer's exceptions to the Trial Examiner's decision did not specifically mention the exclusion of the second reason they were "broad enough to include this within their scope." *Id.* at 701. Accordingly, the Court held that Section 10(e) was not applicable to the case. There is no comparable situation here, as petitioners filed no exceptions to the Trial

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[7] In *U.S. v. Tucker Truck Lines, Inc.,* 344 U.S. 33, 37, the Court rejected the contention that once an agency takes a position on a given issue, subsequent failures to raise the issue are excused: ". . . the commission is obliged to deal with a large number of like cases. Repetitions of the objection in them might lead to a change of policy, or if it did not the commission would at least be put on notice of the accumulating risk of wholesale reversals being incurred by its persistence."

Examiner's initial decision and the exceptions which they filed to his second decision did not even remotely raise a recoupment issue. It is true, that after holding that Section 10(e) was inapplicable to the case before it, the Court, in dictum, expressed the opinion that even if that section did apply, extraordinary circumstances were presented. It appears that all parties to the litigation were primarily concerned with whether the first reason assigned by the employer constituted a sufficient legal ground for refusing reinstatement and gave scant attention to the second reason which did not assume determinative importance until after the Board ruled adversely to the Company on the first reason. We submit that failure of counsel "to see the trees for the forest," *Spiewak, supra,* 179 F.2d at 702, should not constitute extraordinary circumstances and the cases cited in the text so hold. In any event, the *Spiewak* dictum is inapplicable here. Here, we are not dealing with a situation in which counsel pushed one theory of defense while leaving another relatively dormant. Rather, remedy is involved. Charging parties such as petitioners institute proceedings before the Board because they have suffered injury which they wish remedied. Petitioners should not be heard to say that they overlooked their injury because they were more concerned with establishing that a violation of law had occurred. At the very least, this argument is inconsistent with petitioners' major contention that they did not ask the Board for a recoupment remedy because they did not believe the Board had the power to grant it.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition to review should be denied.

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April, 1968

CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

MARCEL MALLET-PREVOST,
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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

COMMODORE WILLIAM MOSS, Appellant, vs. LAWRENCE E. WILSON, Appellee.	)	No. 22198

APPELLEE'S BRIEF

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UNITED STATES COURT OF APPEALS

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APPELLEE'S BRIEF

JURISDICTION

The jurisdiction of the United States District Court to entertain appellant's petition for a writ of habeas corpus was conferred by Title 28, United States Code, section 2241. The jurisdiction of this Court is conferred by Title 28, United States Code, section 2253, which makes a final order in a habeas corpus proceeding reviewable in the Court of Appeals when, as in this case, a certificate of probable cause has issued.

STATEMENT OF THE CASE AND FACTS

Appellant's application for a writ of habeas corpus was first filed in the federal District Court on October 11, 1966 (CT 5). The District Court issued an order to show cause on this same date (CT 33). Appellee's return to the order to show cause was filed on November 25, 1966 (CT 158). A copy of the clerk's transcript of the state municipal court proceedings concerning appellant was

attached to the return and the reporter's transcripts of both municipal and superior court proceedings were lodged with the Clerk of the District Court (CT 160, 162, 168).

Thereafter, on April 12, 1967, the District Court entered an order appointing counsel to represent appellant (CT 217). An evidentiary hearing was held on May 19, 1967. The issues considered at the hearing were whether appellant's plea of guilty was knowingly and understandingly entered with some understanding of the consequences and whether he had effective assistance of counsel (RT 24).[1/]

By way of background it is to be noted that appellant was initially charged in this matter with violating California Penal Code section 217 (assault with intent to commit murder) and sections 187/664 (attempted murder). He was first arraigned on the charges in the municipal court on July 3, 1964 (CT 168). On that same date appellant requested that the court appoint counsel to represent him and on July 6, 1964, Gerald Ragan accepted the appointment (CT 168).

Appellant next appeared in the municipal court, with counsel, on July 7, 1964 (CT 168). The court at that time stated that it had previously explained each of the charges to appellant. Counsel waived formal reading of the complaint and any advice as to rights, and appellant plead

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1. "RT" refers to the Reporter's Transcript of the hearing held in the United States District Court.

not guilty to each of the charges (RTM 2).[2] Counsel stated that he had explained the purpose of a preliminary to appellant and it was the desire of both he and appellant to waive such a hearing (RTM 2-3). The court fully questioned appellant personally as to his understanding of the nature of the proceeding (RTM 3). The court accepted appellant's offer to waive the preliminary examination and ordered that he be held to answer in the superior court (RTM 3-4).

Appellant next appeared, with counsel, in the superior court on July 15, 1964 (RTS 2).[3] At that time counsel waived reading of the information and any advice as to rights and asked for a ten-day continuance and order to further investigate the matter (RTS 2). He also requested permission of the court to spend up to $100 on appellant's behalf for a psychiatric evaluation (RTS 2-3).

Appellant next appeared, with counsel, on July 24, 1964 (RTS 4). At that time counsel indicated that appellant had been examined by a Dr. Anderson and in the doctor's opinion there was no legal medical defense to the charges (RTS 4-5). Appellant then pled guilty to a violation of Penal Code section 245 (assault with a deadly weapon), a

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2. "RTM" refers to the Reporter's Transcript of the municipal court proceedings.

3. "RTS" refers to the Reporter's Transcript of the superior court proceedings.

[illegible]

lesser offense included within the offense charged in Count I of the information (RTS 5). Count II of the information, charging attempted murder, was dismissed (RTS 5). Appellant was sentenced to state prison on August 7, 1964 (RTS 7-8).

Both appellant and his former counsel testified at the hearing held by the federal District Court. Appellant testified, in essence, that counsel spent little, if any, time with him, explained very little and that he pled guilty only because counsel told him to (RT 18-19). More specifically, he testified that when he first appeared in the municipal court the complaint was read to him, he was advised of his right to counsel and requested that counsel be appointed to represent him (RT 11-13). He stated that he next appeared on July 7, 1964, and that appointed counsel was there with him (RT 13). However, he stated that he had not seen counsel before going to court on that date and that he had not seen him the day before (RT 13).

He stated that he pled not guilty at this appearance (RT 15). Further, the only matter he might have discussed with counsel prior to that appearance was bail (RT 15). He stated that counsel did not explain to him the purpose of a hearing to be held at the time (RT 16). Furthermore, he stated that his recollection of what occurred was independent from any transcript of the proceedings (RT 15).

Appellant testified he next appeared in superior court on July 15, 1964 (RT 16). He stated that he had not talked to counsel prior to this court appearance (RT 16).

Appellant's next appearance was on July 24, 1964 (RT 18). He indicated that the only time he saw his counsel between the two appearances was for a brief moment in the corridor on the way to the courtroom on the 24th (RT 18). According to appellant the only thing said was by counsel who stated that he did not have time for jury trial (RT 18).

Appellant pled guilty during his appearance on July 24th. At the District Court hearing he testified that he had previously pled guilty because he was told to do so, at the time, by his counsel (RT 19). Further, he stated that he had not discussed his plea with Mr. Ragan at any time before that, that he did not understand the nature of the offense to which he was pleading guilty, that it was a lesser offense than those originally charged nor that it was a felony (RT 19-20).

Appellant next appeared on August 7, 1964, for sentencing (RT 20). Again, he testified that he had not at any time discussed the matter with counsel prior to the appearance (RT 20-23).

Gerald Ragan testified that he was appointed to represent the appellant some time between July 3 and July 6, 1964 (RT 51). He first met with appellant in the county jail on the latter date (RT 51). He had previously taken one page of background notes from the person who notified him of the appointment (RT 53).

The meeting itself lasted between one and one-half and two hours, during which time counsel took two and one-half

pages of detailed notes (RT 53). These notes detailed the appellant's background, including family problems and his version of the incident (RT 54). The notes included only matters related by appellant and did not reflect any advice given him by counsel (RT 55). Mr. Ragan testified that based on his notes and other matters it was his judgment that appellant was quite lucid at the time and understood what was going on (RT 57).

Counsel also testified that, although he had no notes on the matter, he undoubtedly explained in detail the future court proceedings and possibilities. This would include the nature of the charges, the nature of the court proceedings and the possibilities open to appellant in the superior court (RT 55-57).

Mr. Ragan also investigated other aspects of the case. This included an interview with the investigating officer from the Pacifica Police Department and the determination of what the prosecution's case looked like, including what prosecution witnesses' testimony would be (RT 60). He also received phone calls about the case from a Bishop John Cunningham of the Mormon Church and had a psychiatric evaluation made of appellant (RT 60-61, 63). After this he contacted the District Attorney's office regarding a plea to a lesser offense (RT 64-65).

Finally, Mr. Ragan testified that he knows he would not have advised the appellant to plead guilty in court immediately prior to such a plea being entered (RT 65). He

testified that he was sure he would have discussed the matter with appellant first, although he is not certain where such a discussion took place (RT 65, 67). He was certain in his own mind that appellant agreed with the plea at the time (RT 65-66). He was positive that he did not tell appellant he would get probation and that in all probability, he was going to prison (RT 66).

Following the evidentiary hearing the District Court entered its order denying the petition for a writ of habeas corpus (CT 225). In the course of its opinion the court stated:

> "In his application to this Court for a writ of habeas corpus . . . [petitioner] has submitted numerous documents and attempted to raise many issues, only one of which is sufficient to merit consideration in this order. This is his allegation that his plea of guilty to a lesser included offense in one of the offenses initially charged was involuntary and made without the effective aid of counsel. (Footnote omitted)." (CT 225-226).

The court further stated:

> "The evidence adduced at the evidentiary hearing produced an irreconcilable conflict between the views of petitioner and those of Gerald Ragan, Esq., who was petitioner's appointed counsel at his trial in the state courts." (CT 226).

And, finally:

"The Court concludes, on the basis of the entire record and the testimony taken at the evidentiary hearing, that counsel's version of the facts is more believable and better supported by the record and the evidence introduced at the hearing. It further finds that petitioner was properly represented by counsel and that he pleaded guilty with an understanding of the significance of the plea and the consequences steming therefrom. See Knowles v. Gladden, ______F.2d _____(9th Cir. No. 21,216, decided May 3, 1967). In light of the seriousness of the charges against petitioner and the strength of the evidence, a plea of guilty to a lesser included offense on one count was a very reasonable course to pursue." (CT 228).

Appellant's notice of appeal was filed on September 6, 1967 (CT 294).

APPELLANT'S CONTENTIONS

Appellant's plea of guilty in the trial court was uninformed and involuntary and must be set aside.

A. Appellant was deprived of fundamental due process of law in that at no time was he given any real notice of the true nature of the charge to which his plea of guilty was entered.

B. Appellant was deprived of effective aid of counsel in determining his plea.

C. Appellant was deprived of fundamental due process of law in that the trial court judge failed to determine if appellant's plea of guilty was entered voluntarily, with an adequate understanding of the nature of the charge to which he pled guilty, with an adequate understanding of the possible penalties attended therewith and whether, in fact, appellant was actually guilty of a violation.

D. Appellant was deprived of the effective aid of counsel at all stages of the proceedings in the state courts.

APPELLEE'S ARGUMENT

APPELLANT KNOWINGLY AND UNDERSTANDINGLY ENTERED A PLEA OF GUILTY UPON THE ADVISE OF COMPETENT COUNSEL WHO AFFORDED HIM EFFECTIVE REPRESENTATION.

Although appellant's brief presents several assignments of error, they all relate to the one issue presented to and decided by the District Court. That is, whether ". . . his plea of guilty to a lesser included offense . . . was involuntary and made without the effective aid of counsel." (CT 225-226). The District Court properly concluded that appellant's plea was entered voluntarily and with the effective assistance of competent counsel.

As stated in Williams v. Beto, 354 F.2d 698 (5th Cir. 1965), at 704:

"It is the general rule that relief from a final conviction on the ground of incompetent or ineffective counsel will be granted only when the trial was a farce, or a mockery of justice, or was shocking to the conscience of the reviewing court, or the purported representation was only perfunctory, in bad faith, a sham, a pretense, or without adequate opportunity for conference and preparation. (Citing cases)."

It is settled, of course, that a habeas corpus petitioner has the burden of proving his allegation that he was inadequately represented during his criminal trial. Williams v. Beto, supra, at 704; Wilson v. Rose, 366 F.2d 611, 617 (9th Cir. 1966). Furthermore, it is submitted that the posture of this case now is essentially the same as was Knowles v. Gladden, 378 F.2d 76 (9th Cir. 1967), when this Court stated, at pages 766-767:

". . . the district court found specifically that appellant's guilty plea was made voluntarily and with full understanding of the consequences. We cannot set aside this finding unless it is clearly erroneous. F.R. Civ.P. 52(a). On this record there is substantial evidence that appellant entered the plea voluntarily. He did so only after consultation with, and upon the advice of, competent counsel. (Footnote omitted).

In support of his contentions here it is argued, first of all, ". . . that appellant was not at any time informed of the nature of the charge to which he pled guilty -- California Penal Code section 245, assault with a deadly weapon" (AOB 15:7-9). The reasons advanced to explain why appellant did in fact plead guilty include: (1) a deferential and timid attitude toward the courts because of his long experience with the summary procedures employed by the courts in drunk charges; (2) his lack of contact with and advice from counsel, and (3) a previous family disturbance which resulted in appellant's pleading guilty to a charge of assault and battery that led to only a six-months term in an honor camp (AOB 16).

All such arguments fail, of course, where a District Court has found that a petitioner was effectively represented by counsel and knowingly entered a plea upon the advice of counsel -- and such a finding is supported by the record. See Knowles v. Gladden, supra. It is submitted that the record here clearly supports the District Court's findings.

In the first place, appellant's trial counsel testified that he met with appellant for approximately one and one-half to two hours on July 6, 1964 (RT 51-52). He at that time took detailed notes of the information given him by the appellant. These notes were before the District Court judge (RT 53-54). Furthermore, counsel testified that although he had no notes on nor independent recollection of what he told appellant at this time, his standard practice was to always

detail to a client what the future court proceedings would be (RT 55). This would include an explanation of the charged offense and the possible ways of resolving the case in the superior court -- including pleading guilty if he was in fact guilty or negotiating a plea with the district attorney (RT 56-57).

Counsel also testified that he had no independent recollection nor notes from his other meetings with the appellant. He indicates that one logical place for him to have met with appellant was while the latter was held in the jury box prior to court proceedings (RT 63). This would have allowed them five to ten minutes to confer (RT 63). He also stated that he would assume that he would have again met with appellant in the jail, although he had no independent recollection of doing so (RT 63).

However, counsel stated emphatically that he would not have told the appellant to plead guilty without discussing the matter with him (RT 65). Furthermore, he would never have any person plead guilty if that person did not wish to do so and, finally, he was satisfied appellant knew he was going to be convicted of a felony (RT 65-66).

As indicated, appellee submits there is more than sufficient evidence to support the District Court's findings. See Shuman v. Peyton, 361 F.2d 646 (4th Cir. 1966).

Appellant, of course, attacks the determination made by the District Court. This is done primarily by characterizing the testimony presented at the hearing in a somewhat

different light than it must have been viewed by the court itself. For example, it is argued that, ". . . appellant's appointed counsel testified that he met with appellant only once in private during the entire course of the proceedings in the state courts. (D.C. Trans. p. 63)" (AOB 17:19-22). What counsel did in fact say was that he had no independent recollection of going back to the jail to visit appellant. Further, he stated he assumed he would have, but had no such recollection (RT 63). Appellant's argument is repeated, in essence, on page 19, lines 6 thru 9.

Such an argument does not, of course, take into account appointed counsel's testimony concerning his standard practice and procedure. The District Court, on the other hand, took such testimony plus other evidence, weighed it against appellant's own testimony and quite properly found against the latter.

Appellant next argues, in essence, that he was denied due process because the state trial judge did not totally comply with the requirements of Federal Rule of Criminal Procedure 11 in accepting his plea. There are, of course, several answers to this argument.

In the first place, these rules are specifically rules of procedure to be followed by the federal courts. F.R. Crim.P. 1. Furthermore, these rules, " . . . are not constitutional requirements but are procedural merestones established, first by statute and then by the Rules, and effectuated by the Supreme Court in its supervision of

criminal proceedings, in the federal courts." United States v. Schwartz, 372 F.2d 678, 682 (4th Cir. 1967).

Finally, it is to be noted that the federal district judge was well aware of the limited examination of appellant by the state court at the time his plea was entered (RT 87). However, the District Court, after considering all the evidence, quite properly determined that appellant's plea was entered knowingly and with an understanding of the consequences (CT 228).

Appellant's final argument again relates to the assistance rendered by trial counsel. Aside from the contention concerning the amount of time spent by counsel with appellant, he argues that counsel failed to interview the victim or any of the witnesses; that he failed to investigate the case including an investigation of appellant's "possible hypersensitivity to alcohol;" that he failed to make an adequate investigation of a possible insanity defense because he did not have an independent psychiatric evaluation made but relied on an opinion received over the telphone from the "prosecution's county psychiatrist," and finally, that counsel failed to prepare for a "penalty hearing" other than to receive a phone call from the probation officer. Appellee submits that these arguments are entirely devoid of merit.

The record discloses that the only defenses put forward by appellant during the initial interview was a possible blackout theory (RT 54). Furthermore, counsel was well aware of appellant's alcoholic history (RT 73). The blackout theory plus the

alcoholism quite obviously led to counsel's having a psychiatric evaluation made of the appellant. There is no evidence whatsoever in the record to show whether the psychiatrist was the "prosecution's" psychiatrist or the defense's psychiatrist. The point is, of course, that such an evaluation was made.

Furthermore, the record discloses that counsel investigated the facts of the case. He interviewed the investigating officer, found out what was on the police report and what the prosecution case looked like (RT 60). He also determined what the prosecution witnesses would testify to including the fact that their children witnessed the appellant kicking the victim, his wife, and stomping her on the face at the time of the incident (RT 60, 81). Based on his investigation counsel decided to, and did, negotiate a plea to a lesser included offense. Finally, the record discloses that counsel not only talked to the probation officer prior to sentencing, he also received two letters from the appellant during this period -- one of which related to appellant's pre-sentence interviews with the probation officer. These letters were introduced as evidence during the District Court hearing (RT 84-85).

It is submitted that from all the above it is quite clear that appointed counsel's representation well surpassed the standards required by the Constitution. Furthermore, it is submitted that the California Court of Appeal's observation in <u>People</u> v. <u>Ferguson</u>, 255 A.C.A. 589 (1967), might be applicable here. The court there stated at page 592:

"It will not serve the profession of law well, in the long run, for appointed or other counsel to assert that previous counsel was incompetent or unfair in an effort to have a proper convicted felon released. This is not to say that when 'counsel's lack of diligence or competence reduced the trial of a "farce or a sham" [Citation omitted] that nothing should be done or said about it. The facts of this case are such that trial counsel did very well considering what he had to work with."

CONCLUSION

For the foregoing reasons, appellee respectfully submits that the District Court's order dismissing the petition should be affirmed.

DATED: October 23, 1968

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No. 22202

United States Court of Appeals for the Ninth Circuit

ALBERT E. LEUTHOLD, Superintendent of Banks, State of Montana, Helena, Montana, SECURITY BANK, and MINERS BANK OF MONTANA, N.A.,

Appellants,

-vs-

WILLIAM B. CAMP, Comptroller of the Currency,

Appellee.

THE FIRST NATIONAL BANK OF BUTTE and DALY NATIONAL BANK OF ANACONDA,

Appellee-Intervenors.

On Appeal from the United States District Court for the District of Montana

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Brief of Appellants

I.

JURISDICTION

Complaint (R. 2-12) was filed November 23, 1966, against William B. Camp, Comptroller of the Currency. Jurisdiction was based upon 5 U.S.C. Section 1009, and 28 U.S.C., Sections 1331, 1337, 1346, 1348 and 2201. The amount in controversy was alleged to exceed $10,-000. Defendant Camp denied that jurisdiction existed (R. 45). Defendant-Intervenors also denied the jurisdictional allegations (R. 42, paragraph IX). At the proceedings of August 7 and 8, 1967 (Tr. 1 to 224) evidence was adduced relevant to the damages that would be suffered by Plaintiff-Appellant banks under the proposed new management of the First National Bank of Butte.

The District Court held (R. 55) that it had jurisdiction and that all parties had standing to sue. The District Court found (R. 52) that the controversy with Plaintiff-Appellant Miners Bank is in excess of $10,000, and it specifically made no findings as to the damages which would be sustained by Plaintiff-Appellant, Security Bank.

The District Court by an Opinion and Order, dated August 29, 1967 (R. 54) in addition to its holdings noted above, held that the decisions of the Comptroller of the Currency relating to branch banking were subject to

review by U. S. District Courts under the Administrative Procedure Act (5 U.S.C. §1001 et seq. — now 5 U.S.C. §701 et seq). Otherwise the District Court denied all motions. The Opinion and Order was appealed from by giving Notice of Appeal (R. 66) on August 29, 1967, and filing a bond on appeal in the amount of $250 (R. 74). On October 9, 1967, Appellants filed a Statement of Points upon which they relied (R. 71) and a Designation of Record on Appeal (R. 75). The said Notice of Appeal was filed within 30 days of the Opinion and Order in accordance with Rule 73, F.R.C.P.

The Clerk of the District Court failed to enter a formal judgment as required by Rule 58, F.R.C.P. On November 8, 1967, a formal judgment was entered nunc pro tunc as of August 29, 1967, the same date as the District Court's Opinion and Order.

The jurisdiction of this Court depends upon Title 28, U.S.C., Section 1291.

II.

QUESTIONS PRESENTED

A.

Whether, pursuant to Section 36(c)(1)(2) of the National Bank Act, the Comptroller of the Currency may authorize a national bank to maintain a consolidated bank as a branch where state law prohibits branch banks but allows the maintenance of an office, after consolidation, in the location of the consolidating bank.

B.

Whether, pursuant to Section 36 (b)(2)(A) of the National Bank Act the Comptroller of the Currency may authorize a National bank to maintain a consolidated bank as a branch where state law would prohibit the establishment of the consolidated bank as a new branch under Section 36(c) of the National Bank Act.

C.

Whether, pursuant to Section 3(d) of the Bank Holding Company Act (Title 12, §1842(d) U.S.C.) the Comptroller of the Currency may approve the acquisition of the assets of a Montana bank by a Montana subsidiary bank of a Minnesota bank holding company.

III.
STATUTES INVOLVED

A.

Section 36(b) of the National Bank Act, 12 U.S.C., Sec. 36(b)(2) provides in pertinent part as follows:

> "A National bank . . . resulting from the consolidation of a national bank . . . under whose charter the consolidation is effected with another bank . . . may retain and operate as a branch any office which immediately prior to such consolidation was in operation as —
>
> > "(A) a main office or branch office of any bank . . . participating in the consolidation if, under subsection (c) of this section, it might be established as a new branch of the resulting bank. . ."

B.

Section 36(c) of the National Bank Act, 12 U.S.C., Section 36(c)(2) provides in pertinent part as follows:

> "A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches:
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> * * * *
>
> at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to state banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition; and subject to the restrictions as to location imposed by the law of the State on State banks."

C.

12 U.S.C., §81 provides:

> "The general business of each national banking association shall be transacted in the place specified in its organization certificate and in the branch or branches, if any, established or maintained by it in accordance with the provisions of section 36(c) of this title."

D.

Section 5-1028, Revised Codes of Montana, 1947, provides:

> "No bank shall maintain any branch bank, receive deposits or pay checks, except over the counter of and in its own banking house." (Enacted Sec. 101, Chapter 89, Laws of 1927.)

E.

Section 5-1124, Revised Codes of Montana, 1947, provides:

> "When any two or more banks located in the same county or in adjoining counties shall consolidate in accordance with the provisions of Section 5-1021, the consolidated bank may . . . , upon the written consent of the superintendent of banks and under rules and regulations promulgated by him, maintain and operate offices in the location of the consolidating banks." (Enacted Sec. 1, Chapter 129, Laws of 1931.)

F.

Section 5-1021, Revised Codes of Montana, 1947, provides in pertinent part as follows:

> "Any two or more banks . . . may . . . consolidate . . . into one bank under, into and with the charter of either existing bank hereinafter referred to as the consolidated bank . . . .
>
> * * * *
>
> "Upon such consolidation the corporate franchise . . . of such consolidating bank and banks shall . . . be and become merged and continued in and held . . . by the consolidated bank . . . ." (Enacted Sec. 94, Chapter 89, Laws of 1927; amended Sec. 1, Chapter 108, Laws of 1931.)

G.

Section 3 of the Bank Holding Company Act (12 U.S.C. §1842, as amended) provides in pertinent part as follows:

> "(a) It shall be unlawful, except with the prior approval of the Board (Board of Governors of the Federal Reserve System) . . . (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank;
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> * * * *

"(d) Notwithstanding any other provision of this section, no application shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted on July 1, 1956 (misprint U.S.C.A. pocket part — reads July 1, 1966) . . . unless the acquisition of such shares or assets of a State bank by an out-of-state bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication . . . ."

IV.

STATEMENT OF THE CASE

The case was submitted to the United States District Court for the District of Montana on cross motions for summary judgment by plaintiffs and defendant Comptroller of the Currency, and on motion to dismiss by defendant Comptroller and intervenor defendants.[1] After argument was had on these issues trial was had and the Court made Findings of Fact and entered its Opinion and Order.[2] Briefly summarized, the facts are as follows:

On October 1, 1966,[3] Daly National Bank of Ana-

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1 R. 33, 34, 37.
2 R. 51. 54.
3 The essential facts as pleaded in the complaint (R. 2) are admitted in the defendants' responsive pleadings (R. 41, 45), or stipulated at the trial (Tr. 9), or resolved by the Court's Findings of Fact (R. 51).

conda, Montana, ("Anaconda Bank") applied to James J. Saxon,[4] Comptroller of the Currency ("Comptroller") for his approval of a proposed consolidation with The First National Bank of Butte, Butte, Montana, ("Butte Bank") under the charter of the Anaconda Bank and with the title "First National Bank." In the application it was proposed (Pl's Exh. 10, p. 3) that the Butte bank be maintained as a branch of the consolidated bank, to be called "First National Bank, Butte Division."

Northwest Bancorporation of Minneapolis, a bank holding company, owns 2912 of the Anaconda bank's 3,000 outstanding shares (Tr. 17, 18). Under the proposed consolidation (Pl's Exh. 11) the stockholders of the Butte bank were to receive shares of Northwest Bancorporation stock in return for the transfer of the assets of their bank to the Anaconda bank. (Alleged by Plaintiffs, R. 4, Par. 9; admitted by Defendant Camp (R. 46 Par. 6) and Intervenors (R.42, Par. VI.))

On September 29, 1966, at the request of Plaintiff Albert E. Leuthold, Montana Superintendent of Banks, Forrest H. Anderson, Attorney General of Montana, rendered an opinion (Pl's Exh. 1) that a national bank formed by consolidating two national banks in Mon-

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4 Plaintiffs' Exh. A, proceedings of August 7, 8, 1967.

tana may conduct a banking business in the location of only one of the consolidating banks.

This action was commenced on November 23, 1966, to obtain a declaratory judgment (a) that the comptroller is prohibited by 12 U.S.C. §§ 36 and 81 from approving the application of the Anaconda bank under the title "The First National Bank" to conduct its banking business in more than one location in Montana; (b) that the Comptroller is prohibited by 12 U.S.C. §1842 and Public Law 89-485 from approving the consolidation of the Anaconda and Butte banks, and for injunctive relief against the consolidation and proposed branch bank.

Subsequently the Anaconda bank and the Butte bank intervened as parties defendant.

On August 29, 1967, the District Court rendered its opinion and Order, (R. 54) denying all pending motions and denying all relief to Plaintiffs. In its Opinion and Order the District Court held:

1. That all parties plaintiff have standing to sue.
2. That the District Court had jurisdiction of the controversy.
3. That the decisions of the Comptroller relating to branch banking are subject to review under the Administrative Procedure Act.[5]

In its opinion the District Court concluded that the

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5 5 U.S.C., §1001, et seq. (Now U.S.C., (Now 5 U.S.C., §701, et seq.)

Montana statute providing for the maintenance of an additional *office* after the consolidation of two banks constituted an exception to the Montana statute prohibiting *branch banks*. In doing so the District Court reasoned that the term "office" must have been intended by 1931 legislators to mean "branch bank" because there was, in 1931, no other image of a bank office than a full-fledged branch bank.

Concerning the Bank Holding Company Act aspects of the case, the District Court concluded that 12 U.S.C., §1842(a) allows a Montana subsidiary bank of a foreign holding company to acquire the assets of another Montana bank, and that 12 U.S.C., §1842(d) does not limit that right.

The District Court did not consider in any way the applicability of 12 U.S.C., §36(b).

Following the District Court's Opinion and Order, Plaintiffs filed notice of appeal and moved for an injunction restraining approval of the application until this appeal had been heard and decided. The District Court denied that motion. The same motion was made by Plaintiffs in this Court and the motion was again denied. Shortly thereafter the Comptroller issued his certificate approving the application, the consolidation was effected, and the Butte bank is at this time doing business as a branch of the Anaconda bank.

V.

SPECIFICATIONS OF ERROR

1. The District Court erred in refusing to grant plaintiffs' prayer for declaratory relief and injunction.

2. The District Court erred in refusing to grant plaintiffs' Motion for Summary Judgment.

3. The District Court erred in denying plaintiffs all relief.

4. The District Court erred in its failure to find that damages will be sustained by plaintiff Security Bank as a result of the proposed consolidation.

5. The District Court erred in that it failed properly to construe and apply the pertinent provisions of statutory law, including, but not limited to, the following:

12 U.S.C., §36(c)(2)

12 U.S.C., §36(b)(2)

12 U.S.C., §81

12 U.S.C., §1842, as amended by Public Law 89-485

Sec. 5-1028, R.C.M., 1947

Sec. 5-1124, R.C.M., 1947

VI.

SUMMARY OF ARGUMENT

Branch banking has been a source of concern to the national Congress and to the state legislatures for more than forty years. Until the McFadden Act of 1927, (44

Stat. 1228) and the Glass Acts of 1933, (48 Stat. 189) state chartered banks had a strong competitive advantage with their free access to branching. With the passage of the McFadden and Glass Acts, Congress equalized the competitive aspects of banking.

Branch banking is not a subject that banking people are neutral about. Any review of banking legislation over the recent past testifies to this. A review of recent banking litigation also reveals a strong predilection on the part of Comptroller Saxon, the predecessor of defendant in this case, to advance the competitive advantage of national banks over state banks, by the too-ready approval of branches, and consolidation, that have frequently been proscribed by state law. We view the consolidation here as proscribed by both Montana statute, the National Bank Act, and the Bank Holding Company Act.

It is Appellants' contention that when the Montana legislature prohibited *branch banking* in 1927 it prohibited it in all its various forms; that when it passed a separate law on the subject in 1931, allowing *offices* to be maintained after consolidation of two banks, it intended to allow only a limited form of branch banking. We base this contention on (a) historic considerations and (b) standard rules for interpreting legislative intent.

Appellants contend that if we must interpret the

Montana statutes to determine that *branch banking* was intended by allowing *offices,* the requirements of Sec. 36(c) of the National Bank Act are not met because the statute law of Montana would then only allow branching by implication.

In any case Sec. 36(b) of the National Bank Act prohibits the conversion of the Butte bank into a branch of the Anaconda bank because under Montana law it could not be established as a new branch.

Finally, Appellants contend that the Bank Holding Company Act absolutely prohibits the acquisition of the Butte bank by a Minnesota holding company, whether it makes the acquisition by means of a subsidiary or directly.

VII.

ARGUMENT

A. Section 36(c) of the National Bank Act Prohibits the Maintenance of a Branch Bank After Consolidation of Two National Banks.

1. *At the time of enactment of Sec. 5-1124, R.C.M. 1947, the concept of a banking office as something less than a branch was well known.*

It is now well settled that national banks may maintain branch banks to the same extent as state banks. No more, and no less. The Supreme Court of the United

States has recently held[6] that when Congress enacted §36(c)(1) and (2) of the National Bank Act it "intended to place national and state banks on a basis of 'competitive equality' insofar as branch banking is concerned."

Accordingly, when a national bank seeks to branch one must look to the law of the state where the branch is to be located to determine whether that state permits branching, and if it does, to what extent.

Appellants contend that *branch banking* in its unrestricted sense is prohibited in Montana; and we concede that *branch banking* in a limited sense is allowed in Montana, to the extent that an *office* may be maintained after consolidation; but contend that an *office* in Montana is something less than a branch bank, and was so intended to be by the 1931 Montana Legislature.

Appellees contended in the District Court that the term *office* in Sec. 5-1124, R.C.M. 1947, must mean *branch bank* in the unrestricted sense because it could not mean anything else. The District Court adopted Appellee's contention (R. 61), saying:

> "In the absence of a compelling reason for believing that the word 'office' was used in some limited

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6 **First National Bank of Logan, Utah, v. Walker Bank and Trust,** and companion cases, 385 U.S. 252, 87 S. Ct. 492 (1966). In this case the Comptroller argued that because the **concept** of branch banking was acceptable in Utah, national banks could branch willy nilly without regard to the limitations on branching imposed on state banks. The Court rejected the argument with the comment, "It is a strange ar-argument that permits one to pick and choose what portion of the law binds him."

> sense, it must be given its ordinary meaning, and in its ordinary meaning the word 'office" describes a place where banking business is done."

The District Court also said (R. 60):

> "The main problem is to find the intention of the legislature. The first place to look for that intention is in the words used. What did a Montana legislator reading the word 'office' in the bill which became §5-1124 contemplate? Did he envisage a space in which tellers stood behind counters, received deposits and cashed checks, and officers sat at their desks, frowned and made loans? It is probable that he did, because in Montana, at least, there is no other image of a bank office.[7]

Putting to one side for the moment the rules for interpretation of legislative intent, ignored by the District Court, Appellants will first argue against the District Court's line of reasoning.

The term *branch bank* is a generic term which embraces any banking activity conducted at a location away from the parent banking institution. The Federal Reserve Board in an analysis of branch banking[8] said under the heading, "Terminology":

> "In the following summaries it will be noted that different terms are used in certain states in place of the term 'branches.' These are 'agencies,' 'offices,' 'branch banks,' 'stations,' and 'locations.'

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7 It should be noted that in Montana there is no image of a branch bank. There has never been a branch bank in Montana.

8 FEDERAL RESERVE STUDY OF BRANCH BANKING IN THE UNITED STATES, 1932 Fed. Res. Library, H G 1617 V. I, Vol. 2, p. 182.

"Most of these terms seem to have been adopted as euphemisms for branches where prejudice or law stood in the way of branch operation. This is the case with 'offices,' 'additional offices,' tellers' windows,' 'stations,' and 'locations.' *In general also these terms connote a limitation of function, as in Iowa and Wisconsin, where the purpose is to restrain branches from competing on equal terms with single office banks.*

* * * * *

". . . The word branch has been used, therefore, as the general synonym for all the special and local terms, such as 'branch bank,' 'agency,' 'office,' . . ." (Emphasis supplied)

The foregoing reflects the understanding of the Federal Reserve Board, writing in 1932, shortly after the Montana *offices* statute was enacted. Purely as a a semantic argument then it is logical to say that in 1927 Montana prohibited branch banking (Sec. 5-1028, R.C.M. 1927), in any and all of its conceivable forms. It follows then that when the Montana legislature enacted the *offices* statute in 1931 it intended to allow a limited form of branch banking, that is to say, *offices*. Especially is this true if it can be demonstrated that there was in 1931 an antipathy to branch banking and a knowledge of, and a demand for, a subsidiary banking facility that was something less than a complete branch bank. Such a knowledge and demand can be demonstrated.

Prior to 1927 when the McFadden Act (44 Stat.

1228) was enacted, national banks were absolutely prohibited from maintaining branch banks. Attorney General Wickersham had rendered an opinion on May 11, 1911,[9] that a national bank was restricted in the carrying on of a general banking business to one office or banking house in the place designated in its certificate of organization. Under this ruling national banks suffered a considerable competitive disadvantage because state chartered banks were branching extensively. The result was the conversion of national banks to state charters to meet the competition. In an apparent effort to combat this problem, the Secretary of the Treasury sought an opinion from Attorney General Daugherty, modifying the Wickersham opinion.[10] The Secretary of the Treasury's request asked about the power of national banks "to open and operate *offices* at places other than their banking houses." (See Appendix A)

In response to this request Mr. Daugherty, on October 3, 1923, rendered his opinion. (Appendix A) The substance of his opinion, so far as we are concerned, is:

> ". . . a national banking association may establish in the city or place designated in its certificate of organization an *office or offices* for the transaction of business of a routine character, which does not

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9 29 Op. Atty. Gen'l. 81.

10 THE BRANCH BANKING QUESTION, Charles Wallace Collins, The MacMillan Company, 1926. Library of Congress HG 1616 C6 (Mr. Collins was a former Deputy Comptroller of the Currency).

> require the exercise of discretion . . . It may not, however, establish a branch bank to do a general banking business. . . ."

Following this opinion and on October 26, 1923, the Comptroller of the Currency issued regulations "relating to the establishment of additional offices by national banks." (Appendix B)

Roy A. Young, Governor of the Federal Reserve Board testified in 1930,[11] concerning "branches, agencies, or additional offices," repeatedly differentiating in that fashion, with the implication that they were three distinct concepts.

2. *A Montana Legislator in 1931 could see a need for banking offices but not for branch banking.*

Beginning in 1921, Montana banks began to fail, with 21 failures that year. There were 31 in 1922, 77 in 1923, 46 in 1924, and 28 from 1925 to 1929. A total of 203 bank failures.[12] The vast majority of failures were in extremely small, and frequently isolated towns. (Appendix C) Of the 203 failures only 23 were in such relatively sophisticated cities as Butte, Glasgow, Helena, Missoula, Whitefish, Billings, Great Falls, Laurel, Lewistown, and Miles City.

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11 Hearings before the House Committee on Banking and Currency under H. Res. 141, 71st Cong., 2nd Sess., Vol. I, Part 1, p. 441 et seq. (1930).

12 Id. pp. 361-364 or Note 11, pp. 361-364.

This was a matter of some concern to the Congress when it held hearings on branch, chain, and group banking in 1930. E. W. Decker, representing Northwest Bancorporation (the holding company owning Intervenors here) testified at the House Committee Hearing[13] concerning Montana and the Dakotas:

> "The feeling exists throughout our entire district and in my judgment to attempt to force branch banking at this time on those people, in lieu of group banking would stir up the biggest hornet's nest that you have seen for some time, because that is a big country and there are a lot of people and a great many banks, and they are *unalterably opposed to branch banking.*
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> * * * *
>
> "In the small towns, the so-called crossroads towns, I will admit that we have a real problem. A town which is so small that it cannot support a unit bank, regardless of whether it is independent or in a group, but which is large enough to be entitled to some banking facilities, will probably need *some kind of a branch or teller's window.*" (Emphasis supplied)

From this material it is beyond question that at least from 1923 the concept of *offices* as something other than branches was well known and accepted. And it is apparent from this material that the concept of *offices* embraced the conduct of extremely limited banking functions. Both the Attorney General's Opinion and the Comptroller's regulations had wide circulation

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13 Note 11, p. 795.

among bankers.[14] Presumably the Comptroller's Regulations were disseminated to all national banks.

And so in 1930, an officer of a bank holding company, with banks in the Montana area, testified to the need in Montana of some kind of a branch bank or teller's window, and of the unalterable opposition of the people to branch banking. This testimony was given a scant year before the 1931 Montana legislature enacted the statute providing for *offices* upon consolidation.

In July 1930, a leading banking publication published an aritcle by the Commissioner of Banks of Minnesota calling for legislation that would provide "some kind of banking service" in Minnesota and other states, citing the loss of 154 banks in Minnesota in the past 10 years. (Appendix D)

The District Court's conclusion that a 1931 Montana legislator had only the image of a *branch bank* before his eyes when he voted "aye" on the statute in question, does not appear to be accurate. Banking *offices* that were something less than a branch bank were a well known entity. There was thought to be a need for some kind of banking facility in the many "cross-road" towns

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14 JOURNAL OF THE AMERICAN BANKERS ASSOCIATION, Nov. 1923, p. 322, in which the Comptroller's Regulations concerning limited offices were printed in full.

of Montana. And Montana had a four-year-old statute prohibiting branch banking.[15]

Perhaps the key to the District Court's reasoning is the use of the present tense in the statement: ". . . in Montana, at least, there is no other image of a bank office." That is probably true for today. The statute in question had been on the books for thirty-five years when Intervenor-Appellees made their application, the first application that has ever been made to consolidate *and* branch. (There have been other mergers but no attempts at branching.) But the problem here is not the image of today; rather it is the image of 1931 with which we are concerned. That image included an antipathy to branch banking and knowledge of a facility that was something less than a branch bank.

3. *The Montana Statute is Sui Generis.*

At about the time the Montana statute was enacted 8 states permitted state-wide branching by specific statute; 19 states, including Montana, prohibited branch banking in any form; 11 states permitted branch banking in limited areas; 3 states permitted limited banking activities outside of the parent bank; and only 7 states

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15 We will concede the District Court's characterization of the Frowning Banker with our own observation that Montana Bankers did not have much to smile about in 1931.

were so indifferent on the subject as to have no legislation one way or the other. (Appendix E)[16]

Of the three states—Vermont, Iowa, and Wisconsin—that permitted limited banking activities outside of the parent bank, Vermont permitted "Agencies";[17] Wisconsin[18] provided for "receiving and disbursing stations" limited to towns of less than 800 persons; and Iowa[19] on March 19, 1931, amended its statute prohibiting branch banking by adding a provision that

> ". . . any banking institution may establish an *office* for the sole and only purposes of receiving deposits and paying checks and for performing such other clerical and routine duties not inconsistent with this act. No banking institution may establish any office beyond those counties contiguous to the county in which said banking institution is located. . . . No office shall be continued at any place after a banking institution has actually commenced business at that place . . . ."[20] (Emphasis supplied)

After the 1931 Montana legislature enacted Sec. 5-1124, Montana stood alone in its posture of forbidding

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16 Note 11. In the hearings before the House Banking and Currency Committee, 1930, this statement of former Comptroller Dawes, ". . . the subject of branch banking — the outstanding problem in our banking system today," was introduced (p. 226). And Governor Young testified, p. 419, "The Board feels that group, chain, and branch banking presents one of the most important and most difficult problems of our changing banking structure before the country at the present time."

17 Note 8, p. 204.

18 Id., p. 206 or Note 8, p. 206.

19 Id., pp. 190, 191 or Note 8, p. 190.

20 Relative to the last discussion it is interesting to note the use of the word **office**, and the apparent awareness of the Comptroller's 1923 Regulations — Appendix B, limiting activities to the receipt of deposits, cashing checks and "routine" duties.

branch banking by one statute, and permitting the maintenance of an office after the consolidation of two banks by another statute. So far as we can determine Montana still stands alone in this. This statute being *sui generis*, and never having been availed of for branching purposes in 35 years, it must be interpreted in light of the historical background, *supra,* and the rules of statutory construction and determination of legislative intent, *infra.* The District Court's conclusion of what the 1931 legislature intended by the word *office* is at best one man's conjecture, uninhibited by recourse to the banking problems of the day or standard legal rules of interpretation.

4. *Rules of statutory construction and interpretation of legislative intent dictate a construction that offices means something less than branch bank.*

In a discussion of this aspect of the case it is important to bear in mind that branch banking was prohibited in Montana in 1927 with the enactment of Sec. 5-1028; and that *offices* after consolidation were authorized by Sec. 5-1124 in 1931. If the District Court is to be upheld in this case this Court must conclude that the non-branching statute was repealed or amended by the *offices* statute.[21]

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21 There are no verbatim records made of Montana legislative proceedsings, nor are there any committee reports that disclose legislative intent.

Repeals by implication are not favored by the courts.[22] The District Court ruled in effect that the non-branching statute was repealed to the extent that when two banks merged, a branch bank could be maintained in the location of the acquired bank. But, the legislature did not use the word *branch bank*; it used the word *office*. Accordingly if there was a partial repeal of the non-branching statute it was an unfavored implied repeal. In such a case the Montana Supreme Court has held:[23]

> "It will not be presumed that a subsequent enactment of the legislature intended to repeal former laws upon the subject, when such former laws were not mentioned. It is our duty to reconcile the statutes if it appears possible to do so, consistent with legislative intent. We bear in mind the rule that an implied repeal results only from an enactment, the terms and necessary operation of which cannot be harmonized with the terms and necessary effect of an earlier act. (Citing cases)
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> "The presumption is that the legislature passes a law with deliberation and with full knowledge of all existing ones on the same subject, and does not intend to interfere with or abrogate a former law relating to the same matter unless the repugnancy between the two is irreconcilable." (Citing cases)

Kindred to this rule is the following:[24]

> "The use by the legislature of certain language in one instance and wholly different language in the

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22 Cope v. Cope, 137 U.S. 632.
23 Fletcher v. Paige, 220 P.2d 484.
24 50 Am. Jur., Statutes, §274.

> other indicates that different results were intended, and the courts have even so presumed. Under this rule where language is used in one section of a statute different from that used in the other sections of the same chapter, it is presumed that the language is used with a different intent."

It is not difficult to harmonize the two statutes. The legislature can be presumed to have had knowledge that the U. S. Attorney General had ruled that national banks could maintain a banking office which was not a full scale branch bank. Any interpretation of legislative intent should take into account the intense feeling throughout the country about branch banking and the fact that Montana had joined the states that were opposed to it only four years before. Certainly every Montana legislator was painfully aware of the bank failure debacle of the '20s and the concomitant loss of even the minimum banking services in literally hundreds of small Montana communities.

If there is any substance to the rule that the legislature intended a different meaning when it used a different word in a later statute, this is clearly a case for application of the rule.

5. *Section 36(c) of the National Bank Act permits branching only when a state statute specifically permits it, and prohibits branching when a state statute allows it by implication. Sec. 5-1124 allows branching by implication, if at all.*

The pertinent language in Sec. 36(c) allows national banks to establish new branches:

> ". . . if such establishment and operation are at the time authorized to state banks by the law of the state in question *by language specifically granting such authority affirmatively and not merely by implication. . . .*" (Emphasis supplied)

There is no language in Sec. 5-1124, R.C.M. 1947 which *affirmatively* gives authority to state banks to branch. There is no language which *specifically* grants the authority to branch. State banks are only allowed to maintain an office. Conversion of *office* to *branch bank* must be accomplished by implication.[25] Whether or not the implication is warranted, it is an implication nevertheless. Appellants submit that under Sec. 36(c) branching by national banks would be permissible in Montana only if a Montana statute allowed branch banks *in haec verba.* Especially is this true in this case where the legislature can be presumed to have intended a different meaning by using a different word. If the non-branching Sec. 5-1028 had not been on the

25 No state bank has ever attempted to branch under this statute. The Montana Atty. General has held that branch banking is not permissible under Sec. 5-1124 (Pl's Exh. 1). Appellants do not contend that the Atty. General's Opinion is binding on the Comptroller. However, we do note that the "competitive equality" endorsed by the Supreme Court of the United States in the Utah cases, footnote 1, has been put out of balance by the District Court's decision, with the result that national banks can branch in Montana, and state banks cannot. It is axiomatic that the Montana state courts are not bound by federal court interpretations of state law; therefore the imbalance may well be permanent.

books, or if the word *office* had been used in 5-1028 instead of *branch bank,* the results would perhaps be different.

B. The Comptroller Improperly Authorized the Anaconda Bank to Maintain the Butte Bank as its Branch in Complete Disregard of the Provisions of Section 36(b)(2) of the National Bank Act.

1. By enacting Section 36(b) of the National Bank Act in 1962, Congress provided a means to retain existing branches after a consolidation which could not have been retained under prior law.

In 1962 Congress enacted Section 36(b)(2) of the National Bank Act, 12 U.S.C. Section 36(b), which in part states:

> "(2) A national bank * * * may retain and operate as a branch * * * A main office or branch office * * * if, under subsection (c) of this section, *it might be established as a new branch* * * *" (Emphasis supplied)

If we rephrase the foregoing subsection to include the names of the banks involved in this controversy, it reads as follows:

> (2) The Anaconda Bank * * * may retain and operate as a branch * * * the main office or branch office of the Butte Bank * * * if, under subsection (c) of this section, the main office or branch office of the Butte Bank might be established as a new branch * * *

Our contention is that if the Anaconda bank were a state

bank it could not establish a new branch in Butte under the Montana Statutes; and as a result, that the Anaconda Bank, a national bank, under subsection 36(c) may not establish a new branch in Butte. The result is that under the above prohibition, the Anaconda Bank may *not* retain and operate the Butte Bank as a branch.

So far as we can determine, the District Court did not consider the provisions of Section 36(b)(2) in any manner.

We will now review the history of pertinent parts of 12 U.S.C. Section 36(b) and (c). Our aim is to show that our interpretation of 12 U.S.C. Section 36(b) is consistent with the expressed intent of Congress.

As enacted on March 3, 1865, Revised Statutes Section 5155, now 12 U.S.C. Section 36, made it lawful for any bank organized under state law to become a national bank association, and to retain and keep its branches. This provision remained unchanged from 1865 to 1927.

At the turn of the century, there were very few branch banks in the country. There were only 5 national and 82 state banks operating branches for a total of 119 branches. By the end of 1923 91 national banks and 500 state banks had a total of 2,054 branches.[26]

Following this rapid increase in branching, on February 25, 1927, the National Bank Act was amended

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26 Note 6, p. 257 (495 S. Ct. Rep.)

by 44 Stat. 1228, 12 U.S.C. Section 36. Under Section 36(b) as enacted in 1927, where two national banks consolidated, the remaining bank could retain and operate any branches which had been in lawful operation on February 25, 1927. Section 36(b) remained unchanged from 1927 to 1962. It is significant that the original Section 36(b) had no provision under which consolidating banks could retain the main office of a participating bank as a branch. Had the Anaconda Bank attempted a consolidation with the Butte Bank prior to 1962, there was no provision under Section 36(b) which would have allowed the retention of the main office of the Butte Bank under any circumstances.

The next pertinent amendment to 12 U.S.C. Section 36 was made in 1933. Congress enacted 48 Stat. 189 which amended Section 36(c). Such amendment added the present first 11 lines which make up the entire first sentence of Section 36(c). As a result of this 1933 amendment, a national bank was authorized to establish and operate new branches at any point within the state in which the association was situated, if the establishment and operation were authorized to state banks by statute law specifically granting such authority affirmatively and not by implication. As a result, starting in 1933 and continuing to the present time, a national bank could establish and operate new branches if the law of

the state in question affirmatively and not by implication, grants similar authority to a state bank. On September 28, 1962, Congress enacted what is now 12 U.S.C. Section 36(b) as a part of 76 Stat. 667. That enactment was made under H.R. 12899, which superseded H.R. 12825. The purpose of the 1962 amendment is set forth in Senate Report No. 2040, 1962 U.S. Code Cong. and Adm. News 2733-2735, a full copy of which is included as Appendix F to this brief. Senate Report 2040 points out that the purpose of the 1962 bill was to allow the retention by a national bank of existing branches upon a consolidation. This is stated in 1962 U.S. Code Cong. and Adm. News 2734 as follows:

> "* * * The bill would permit the retention, with the approval of the Comptroller of the Currency, of any branch of the bank under whose charter the consolidation is carried out, provided that a State bank carrying out a similar consolidation would not be prohibited from retaining a similar branch. * * *"

Senate Report 2040 emphasized that the purpose of Section 36(b) prior to the 1962 amendment was to prevent a bank from acquiring branches by taking over other banks in the states where branches could not be legally established under state law; and further pointed out that the retention of branches already in existence after a consolidation would not violate this purpose. This is stated at 1962 U.S. Code Cong. and Adm. News at page 2734 as follows:

> "*The purpose of the existing law is to prevent a bank from acquiring branches by taking over other banks where such branches could not legally be established under State law.* However, this purpose does not apply to the branches of a bank under whose charter a consolidation is carried out, and no public interest is served by requiring such a bank to give up its legally established branches already in existence." (Emphasis supplied)

Note that the amendment did not change the primary purpose which was the prevention of a bank acquiring branches by taking over other banks in the states where branches could not be established under state law. That statement of purpose is pertinent in Montana where no branches can be legally established under Montana Statutes.

In the 1962 amendment of 12 U.S.C. Section 36(b)(2) is the first reference to the retaining of main offices as branches. It is significant that the Senate Report emphasizes that the bill will allow the retention of branches of a bank whose charter will cease to exist by consolidation, and also the retention of main offices as branches, if all of such branches could be established on original application. This is stated in 1962 U.S. Code Cong. and Adm. News at page 2735 as follows:

> "* * * In so doing, it would preserve the existing permission for the retention of all branches of the banks whose charters will cease to exist by the merger or consolidation, and the retention of their main offices as branches, if such branches could be established on *original* application under the law of the

> State at the time of the merger or consolidation." (Emphasis supplied)

Note that the intention of the Congress was that the retention of a branch or of a main office of a bank which will cease to exist on consolidation would take place only if such a branch could be established on original application under state law.

Mr. Saxon, who was Comptroller of the Currency until just prior to the commencement of the present action, appeared before the Committee on Banking and Currency of the House prior to the 1962 amendment of Section 36(b). He emphasized that all the 1962 amendment does is to permit the retention of branches already in lawful operation by the charter bank and no more. His views are set forth in the reports on the Hearing before Subcommittee No. 1 of the Committee on Banking and Currency, House of Representatives, 87th Congress, on H.R. 12825 subsequently superseded by H.R. 12899 at page 5, where Mr. Saxon stated:

> "The second matter pertains to a minor amendment relating to the branches of national banks. It relates to branches retained upon conversion, consolidation, or merger. The bill is designed to eliminate an existing technical impediment to the conversion of state banks into national banks in certain situations. These are situations in which a State bank desiring to convert into a national bank may not, after conversion, retain as a national bank branches which it had in lawful operation as a State bank.
> * * *

"The bill would provide that such branches may be retained with the approval of the Comptroller, and it would apply to consolidations and mergers as well as conversions.

"*It is important to emphasize that all the bill does is to permit the retention of branches already in lawful operation by the charter bank, and no more.* While this bill is important in the cases in which applicable, it should be pointed out that it is of limited applicability. It would not apply in states having state-wide branch banking, nor would it apply in States which have always prohibited branch banking.

"Of the States having limited branch banking, it would apply only in those states which at one time had more liberal branch laws than at present, or in which, because of intervening factual changes, existing branches could not be reestablished. * * *" (Emphasis supplied)

Mr. Englert appeared with Mr. Saxon and also testified in behalf of the Comptroller's office. Mr. Englert emphasized that the sole purpose of the amendment was to permit a bank which has branches to merge or consolidate and keep the branches. He emphasized there were very few banks in the country and very few states in which the amendment would have any effect. His testimony is set forth at page 8 of the above cited Hearing:

"MR. ENGLERT. I would like to say, Mr. Moorhead, this is a bill of very limited application. It applies only in the case where a State had more liberal branch laws than it now has. The purpose is solely to permit a bank which has branches to

> merge or consolidate or convert and keep the branches which it is then operating, and this would apply only in the case where under existing law these branches could not be reestablished. They were gotten at some time in the past when branching was permitted, but now branching under these conditions is not permitted. So there are very few banks in the country and very few states actually, in which it would have any effect."

As Mr. Saxon pointed out, the 1962 amendment of 12 U.S.C. Section 36(b) did not apply in states having state-wide branch banking, nor would it apply in states which had always prohibited branch banking. Next, Mr. Saxon pointed out that of the states having limited branch banking, the 1962 amendment would apply only in those states which at one time had more liberal branch laws than at present. Montana has never had more liberal branching laws than at present. As a result, it is clear that the Comptroller did not anticipate that the 1962 amendment would apply to Montana.

Our conclusion is that the 1962 amendment of 12 U.S.C. Section 36(b) under which the Appellees are proceeding was not intended by the Congress to cover national banks doing business here in the State of Montana. We emphasize this point in order to eliminate any suggestion that our interpretation of 12 U.S.C. Section 36(b) runs contrary to the intent of Congress.

2. *The main office of the Butte Bank may not be retained as a branch because it*

could not be established under Montana law as a "new branch."

Under 12 U.S.C. Section 36(b)(2), the Anaconda Bank may retain and operate the Butte Bank as a branch "if, under subsection (c) of this section, it might be established as a new branch." Might the Anaconda Bank have established a new branch in Butte? This requires consideration of the provisions of 12 U.S.C. Section 36(c) which in relevant part states:

> "(c) A national banking association may * * * establish and operate new branches * * * if such establishment and operation are * * * authorized to state banks by statute law of the state in question by language specifically granting such authority affirmatively and not merely by implication or recognition * * *"

We should keep in mind that Section 36(c) as material here, was enacted in 1933. It sets the standards for the establishment and operation of new branches, as distinguished from the continuing of any bank or branch previously in existence. Under Section 36(c) the Anaconda Bank, a national bank, may establish and operate a new branch in Butte only if a State bank located in Anaconda may establish and operate a new branch in Butte under Montana Statute law.

There is no Montana statute which allows a State bank to establish "new branches." In contrast, Section 5-1028, Revised Codes of Montana, 1947, provides that

no bank shall maintain any branch bank. In recent years Montana Section 5-1028 has been amended to provide authorization for the creation of detached drive-in and walk-up facilities. By the terms of such amendments, the service to be rendered by these drive-in and walk-up facilities is limited to receiving deposits, cashing checks or orders to pay, receiving payments payable at the bank itself and such other transactions as are normally and usually conducted or handled at teller's windows in the main banking house. Clearly, Montana Section 5-1028 cannot be construed as authorizing an Anaconda State Bank to establish and operate "new branches" in Butte or elsewhere in Montana, as referred to in 12 U.S.C. Section 36(c).

The Comptroller relies on Montana Section 5-1124 as allowing the establishment and operation of new branches by Montana State Banks. As significant here, Section 5-1124, Revised Codes of Montana, 1947, provides that the consolidated bank may "maintain and operate offices in the locations of the consolidating banks."

Does Montana Section 5-1124 meet the tests contained in 12 U.S.C. Section 36? A careful reading of 12 U.S.C. Section 36(b) and (c) determines that it does not. Using the names of the Anaconda Bank and the Butte Bank in place of the general terms of 12 U.S.C.

Section 36(b) and (c), we believe the following accurately restates these subsections as pertinent here:

> (b) The Anaconda Bank, under whose charter the consolidation with the Butte Bank is effected may retain and operate as a branch the main office or branch office of the Butte Bank if, under subsection (c) of this section, such main office or branch office of the Butte Bank might be established as a new branch of the Anaconda Bank.
>
> (c) The Anaconda Bank may establish and operate new branches in Butte if such establishment and operation are now authorized to State banks by the statute law of Montana by language specifically granting such authority affirmatively and not merely by implication or recognition.

The clear intention of Section 36(b) is that the Anaconda Bank can retain the main office or any branch office of the Butte Bank only if the Anaconda Bank could establish a new branch in Butte without any consolidation. This makes good sense. It follows the congressional intent. It does not allow an extension of branching where a consolidation takes place. It merely allows a national bank after a consolidation to retain a branch which it was authorized to establish and operate under the law, even though there were no consolidation.

The standards set up by Congress must be followed. Since 1933 Section 36(c) has set forth the standards for the establishment and operation of new branches. Section 36(b) allows the Anaconda Bank to retain the Butte Bank as a branch only if the Anaconda Bank could have

set up a new branch in Butte under Section 36(c) *in the absence of any consolidation.* No Montana statute can be construed to allow a state bank doing business in Anaconda to establish and operate a new branch in Butte in the absence of a consolidation.

As the standards set up by 12 U.S.C. Section 36 have not been met, the action of the Comptroller in approving the application must be reversed.

C. Acquisition of the First National Bank of Butte by the Holding Company, Northwest Bancorporation, is a Clear Violation of the Bank Holding Company Act of 1956 as Amended, 12 U.S.C. 1842.

Northwest Bancorporation, a Minnesota bank holding company, is attempting here to acquire ownership and control of an independent Montana bank through a purchase of its assets and consolidation with an existing subsidiary bank in Montana. *It is perfectly clear that the holding company could not legally accomplish this result by purchasing either the stock or assets of the independent bank and then consolidating the bank with its present subsidiary. The holding company in this case seeks to avoid the explicit statutory prohibition of such a purchase by characterizing the transaction as a purchase of the assets by its bank subsidiary with a consolidation to form two "divisions" of a new subsidiary.*

The statutory provision which bars further expan-

sion of Northwest Bancorporation in Montana is Section 3(d) of the Bank Holding Company Act, 12 U.S.C. 1842(d) which provides in relevant part that:

> "Notwithstanding any other provision of this section, no application shall be approved under this section which will permit any bank holding company or any subsidiary thereof, to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted . . . unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute law of the State in which such bank is located, by language to that effect and not merely by implication."[27]

This section of the statute was introduced in the Senate debates as an amendment by Senator Douglas of Illinois and overwhelmingly adopted.[28] The statements made by Senator Douglas in favor of the amendment leave no doubt that it was the intention of the Congress to prevent such an acquisition as the one now before this Court — a Montana bank by a Minnesota holding company. In the course of the debate Senator Douglas said:

> "I may say that what our amendment aims to do to do is to carry over into the field of holding companies the same provisions which already apply for branch banking under the McFadden Act — namely, our amendment will permit out-of-State holding

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27 No such authorization is provided in the Montana statutes.
28 102 Cong. Rec. 6857-63, April 24, 1956.

companies to acquire banks in other States only to the degree that State laws expressly permit them; and that is the provision of the McFadden Act.

* * * *

"Our amendment would prohibit bank holding companies from purchasing banks in other States unless such purchases by out-of-State holding companies were specifically permitted by law in such States.

* * * *

". . . so far as inter-state acquisition of banks is concerned, namely, purchase by bank holding companies of banks in other States, the provision in my amendment is in principle almost identical with the present provision which governs branch banking.

* * * *

"However, so far as the bank holding companies are concerned, I want to check their expansion. This seems to me to be about the best way of doing so."

The opponents of the amendment revealed a clear understanding of the effect of the amendment as is illustrated by the statement of Senator Bennett:

"I recognize that it is less severe than the House language which contains a flat, unequivocal prohibition against bank holding companies crossing State lines. But it is only slightly less severe in that it makes a blanket prohibition which can only be lifted by specific affirmative action by the States and in its present form creates an evil which I must oppose.

"The net effect of the amendment is to require every State that does not now have legislation prohibiting bank holding companies to discriminate in favor of such corporations that may be resident in

> their State and against bank holding companies resident in any other State and requires affirmative legislation to remove the discrimination."

and Senator Bricker:

> "So the effect of the Douglas amendment is to absolutely prohibit a bank from crossing State lines.
>
> * * * *
>
> ". . . the committee rejected this amendment. The Federal Reserve Board, the Comptroller of Currency, the Federal Deposit Insurance Corporation, and all the bank holding companies are absolutely opposed to it."

Thus, the debates at this point make it crystal clear that this amendment was to apply across the board to all such out-of-state acquisitions with no special treatment for holding companies to expand then existing multi-state operations.

The House Banking and Currency Committee which considered this bill after its passage by the Senate, stated in its Report No. 609, May 20, 1956, that this provision "confines future *bank acquisitions* by holding companies to the State within which the bank holding company . . ." (is principally located) (Emphasis supplied.) There is nothing to support the idea that this principle of containment and flat prohibition could be evaded merely by using the form of a consolidation with subsidiary banks. Of this idea Senator Douglas himself has stated:

> "This is contrary, in my opinion, at least, to the in-

> tent of Congress expressed in Section 3(d). It certainly is contrary to my purpose in proposing and getting the amendment passed." Hearings S. 2353, S. 2418, and H. R. 7371, before the Senate Committee on Banking and Currency, 89th Cong., 2nd Sess., Part 1, page 67.

In short, the specific intent of this provision is to prohibit the very thing that Northwest Bancorporation is attempting here; to reach out from its home state of Minnesota to take control of another independent bank in Montana.

It is obvious that Northwest Bancorporation is trying to evade this statutory prohibition by cloaking the acquisition in the form of a purchase of assets by a subsidiary bank and thereby find a loophole in the law.[29]

Presumably the legal theory is that Section 3(d) prohibiting out-of-state expansion uses the language "no application shall be approved" and thus does not apply here because of an exemption in the Act permitting this particular form of acquisition without any approval. The exemption is claimed to be found in Section 3(a) where it is provided in part that approval of the Board is required "for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank." The words "other than a bank" are supposed to be the loophole whereby acquisi-

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29 Pl's Exh. 11, Agreement of Consolidation.

tions in the form of asset purchases by subsidiary banks can escape compliance with any part of the Bank Holding Company Act including the flat prohibition on out-of-state expansion.

It is difficult to see how this claimed exception can be upheld in view of the very definite contrary intent of the Congress in enacting the Douglas amendment. Even without the statements of Senator Douglas and others, the language of subsection (d) effectively destroys the exception claimed to exist in subsection (a) for an acquisition by a subsidiary bank. In subsection (d) we find the words "notwithstanding any other provision of this section"; words that perforce reflect back to subsection (a). We find a prohibition against an acquisition by a bank holding company or any subsidiary thereof, omitting the key words of subsection (a): "other than a bank." And we find the prohibition of an acquisition by a holding company either *directly* or *indirectly* which can only have reference to an acquisition by a subsidiary bank.

As Appellants will now demonstrate, however, even assuming the prohibition on out-of-state expansion is ineffective to prevent acquisitions through asset purchases by bank subsidiaries, this case involves a purchase of the assets by the holding company itself directly contrary to the statute. Further, in Section 2 below, Appellants

will show that even where there is an asset purchase truly by a bank subsidiary, the exemption in Section 3(a)(4) does not extend to provide a loophole for out-of-state expansion.

1. *The acquisition of the First National Bank of Butte was in fact accomplished by a purchase of the assets by Northwest Bancorporation and not the subsidiary bank.*

The actual purchaser of the First National Bank of Butte is the holding company itself[30] and the attempt to characterize the transaction as a purchase by the subsidiary, the Daly Bank, is a shallow subterfuge. The consideration to be paid for the assets is stock of Northwest Bancorporation and the corporation which must and will furnish that consideration is the holding company, Northwest Bancorporation. The holding company has admitted that it is acquiring the stock for the very purpose of supplying the consideration for this acquisition. No manner or number of intermediate sham maneuvers can conceal the basic fact that assets are to be sold by Butte bank *not* for any assets owned by the Anaconda bank subsidiary for its own corporate purposes but actually for value supplied by the parent holding company.

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30 Pl's Exh. 11.

Further, the acquired bank in Butte is to remain a distinct and separate operating entity as a "division" of the shell created by formal consolidation. This certainly does not suggest the case of an existing subsidiary expanding to control and operate another bank as a branch in an integrated operation. What is now the First National Bank of Butte will simply become the First National Bank (Butte Division), the equivalent of a new and additional subsidiary of the holding company. Just as the asset purchase is actually by the holding company itself rather than by the Anaconda bank subsidiary, it is also transparent that the transaction is not designed to expand the present Anaconda subsidiary in any real sense but in fact to acquire and maintain as a functionally independent organization another subsidiary of the holding company. Obviously the Anaconda bank is involved here only as an artificial participant. The Anaconda bank is not a sham entity, but its role here is purely artificial and this fact is decisive of this case.

These facts reveal that the holding company is the purchaser here. Therefore the transaction is squarely within the scope of Section 3(a)(4) of the Bank Holding Company Act and the prohibition on out-of-state expansion in Section 3(d).

In a similar case the Court of Appeals of the Dis-

trict of Columbia Circuit[31] pierced the corporate veil, saying:

> "Consequently, we pierce the corporate veil which shrouds this intricate transaction, and see Whitney-New Orleans attempting to establish a branch in Jefferson Parish in violation of 12 U.S.C. §36(c). It is a bootstrap operation by which Whitney-New Orleans, using its own funds in corporate maneuvering, seeks to establish a branch in prohibited territory. Like Jacob of old, Whitney-New Orleans covered its hands with the Esau-like plan of reorganization and, despite the telltale sound of its own voice, obtained the blessing of the Comptroller of the Currency. Unlike Isaac, however, the Comptroller was not gulled by the ruse; acting *ultra vires* in the circumstances shown, he knowingly permitted it because he considered the end desirable, and because he thought the corporate maneuvering impervious to attack. But when the corporate veil is pierced, it becomes apparent that both voice and hands were those of Whitney-New Orleans."

And this Court[32] has declined to pierce the corporate veil in a banking case, on the facts, but has not rejected the possibility in a proper case, saying: "In the banking field, as elsewhere, courts have power to 'pierce the corporate veil' when the realities require it." Certainly if there was ever a situation where the realities require that the corporate veil be pierced, this case provides it.

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31 **Whitney National Bank v. Bank of New Orleans & Trust Co., 323 F.2d 290, 304.**

32 **First National Bank in Billings v. First Bank Stock Corp., 306 F.2d 937 at 942 (9th Circ., 1962).**

2. *The exemption derived from the words "other than a bank" in Section 3(a) is based on the avoidance of duplicating discretionary regulation and does not extend to instances of out-of-state purchases which are prohibited* per se *by Section 3(d).*

The exemption from the general requirement of approval by the Federal Reserve Board for asset acquisitions, contained in the words "other than a bank" in Section 3(a), is based solely on the ground that asset purchases by banks themselves would require approval by other federal or state supervisory authorities. It is not based on any view that expansion in this particular form might be less dangerous to healthy competition in the banking industry than outright stock purchases by the giant holding companies. This is evident in the legislative history of the 1956 Bank Holding Company Act and is not disputed. See Hearings on H.R. 6504 before the House Committee on Banking and Currency, 82d Cong. 2nd Sess., at page 24 (1952); Hearings on S. 76 and S. 1118 before the Senate Committee on Banking and Currency, 83d Cong., 1st Sess., at pages 14, 17, 26 and 50 (1953-54). (See Testimony of Deputy Comptroller of the Currency at page 50.)

Because the exemption in the words "other than a bank" is solely intended to avoid duplication of judg-

ment and responsibility between federal agencies for approval of asset purchases by banks, *this exemption is limited to those cases where Congress intended some discretion to be exercised.* Such cases are expansion through purchases of assets of within-state banks.

In Section 3(d), Congress clearly expressed the intent that no approval was to be given for out-of-state expansion by "any bank holding company or any subsidiary thereof." It means that no exercise of discretion was called for in such cases and that federal policy was to flatly prohibit such expansion. It is just this type of situation in which the exemption for asset purchases by a subsidiary bank does *not* apply. Since the matter involved here is not to be subject to agency judgment the exemption based on letting another agency decide does not cover this.

Any other interpretation produces an absurd reading. It would interpret the statute as saying: "There shall be no out-of-state asset purchases except that subsidiary banks may do so because if this were a discretionary matter it would not be appropriate to place the discretion in the Federal Reserve Board." It is obvious that the loophole theory is based on reading a limitation into the provision prohibiting out-of-state expansion and thereby destroying its effectiveness and frustrating the clear intent. On the other hand, the reading which

matches the intent and reconciles the two subsections is to place the limitation on the exemption provision which was not intended to cover cases where no discretion by the Board would be necessary.

Any other interpretation of subsections 3(a) and 3(d) makes 3(d) an absolute nullity, and we might just as well not have it in the law. But it is a part of the law and it was put there to check the further expansion of bank holding companies across state lines.

The meaning of the section is clearly that the Bank Holding Company Act extends to acquisitions by purchase of assets except where the problem of duplicating the authority of other supervisory agencies requires exemption for such purchases by subsidiary banks. Since out-of-state expansion, however, is by federal policy *never* to be permitted, without specific state statutory authorization, there can be no exemption in this situation.

VIII.

CONCLUSION

The District Court should be reversed.

Respectfully submitted,

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CERTIFICATE

JOHN M. SCHILTZ, one of counsel for Appellants, states as follows:

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing Brief is in full compliance with those rules.

....
JOHN M. SCHILTZ
Attorney for Appellants

CERTIFICATE OF SERVICE

I hereby certify that Brief of Appellants has been served by mailing three copies thereof to each of the following counsel of record in this cause: Moody L. Brickett, United States Attorney for the District of Montana, Federal Building, Butte, Montana 59701 and Stephen R. Felson, United States Department of Justice, Appellate Section, Civil Division, Washington, D.C., Attorneys for Appellee; and to McKeon and Brolin, 122-126 Oak Street, Anaconda, Montana 59711, Johnson & Johnson, 1st National Bank Building, Butte, Montana 59701, and John D. French, 1260 Northwestern Bank Building, Minneapolis, Minnesota 55402, Attorneys for Intervenor-Appellees.

Dated January ...., 1968.

....

JOHN M. SCHILTZ
One of Counsel for Appellants

OPINION

OF

HON. HARRY M. DAUGHERTY OF OHIO

APPOINTED MARCH 5, 1921

POWER OF NATIONAL BANKING ASSOCIATIONS TO ESTABLISH OFFICES

National banking associations have the power to open and operate offices at places other than their banking houses within the place specified in their organization certificate for the performance of such routine services as the receipt of deposits and the cashing of checks for their customers.

National banking associations have no authority to open offices for the purpose of receiving deposits, paying checks, etc., outside of the limits of the city or place designated in the organization certificate as the place of its operations of discount and deposit.

DEPARTMENT OF JUSTICE

October 3, 1923

Sir: I have your letter of August 30, 1923, requesting my opinion on the power of national banking associations to open and operate offices at places other than their banking houses for the performance of such routine services as the receipt of deposits and cashing of checks for their customers. You request to be advised whether:

"(1) Assuming that a national banking association is without power to establish and maintain a branch bank for carrying on a general banking business, has it the corporate power to open and operate an office or offices at a place or places other than its banking house, for the performance of such routine services as the collection of deposits and cashing of checks for its customers?

"(2) If a national banking association has the corporate power to open and operate such an office or offices, must they be located within the city limits of the place designated in the organization certificate of the association as the place where its operations of discount and deposit would be carried on?

The statutes relating to national banking associations, so far as they are material to our present inquiry, are sections 5133, 5134 (par. 2), 5136 (par. 6 and 7), and 5190, R. S. The material parts of said statute read as follows:

"Sec. 5133. Associations for carrying on the business of banking under this Title may be formed by any number of natural persons, not less in any case than five. They shall enter into articles of association which shall specify in general terms the object for which the association is formed and may contain any other provision, not incon-

sistent with law, which the association may see fit to adopt for the regulation of its business and the conduct of its affairs.

* * * * *

"Sec. 5134. The persons uniting to form such an association shall, under their hands, make an organization certificate, which shall specifically state:

* * * * *

"Second. The place where its operation of discount and deposit are to be carried on, designating the State, Territory, or district, and the particular county and city, town, or village.

"Sec. 5136. Upon duly making and filing articles of association and an organization certificate, the association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

* * * * *

"Sixth. To prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

"Seventh. To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this Title.

"Sec. 5190. The usual business of such national banking associations shall be transacted at an office or banking house located in the place specified in its organization certificate."

The provisions of section 5190, R.S., as to the place at which the usual business of the bank shall be transacted refers to the city or town in which the bank is located and not the particular place within the city. McCormick v. Market Nat'l Bank, 165 U.S. 538, 549.

National banks have only those powers specified in the National Banking Acts, and such other powers as are necessarily incidental thereto. McBoyle v. Union Nat'l Bank, 122 Pac. 458; First Nat'l Bank v. Nat'l Exchange Bank, 92 U. S.

122, 127; Logan Co. Nat'l Bank v. Townsend, 139 U. S. 67, 73; Bullard v. Bank, 18 Wall. 589, 593.

In Bullard v. Bank, supra, the Supreme Court said:

"The extent of the powers of national banking association is to be measured by the Act of Congress under which such associations are organized."

In Logan Co. Nat'l Bank v. Townsend, supra, the court said:

"It is undoubtedly true, as contended by the defendant, that the National Banking Act is an enabling act for all associations organized under it, and that a national bank can not rightfully exercise any powers except those expressly granted by that act, or such incidental powers as are necessary to carry on the business of banking for which it was established."

It is to be observed that section 5190, R.S., relates to the "usual business" which, in my opinion, is to be construed the general banking business usually conducted by national banks. There is no statutory requirement that all the business of a national bank shall be transacted at the general office or banking house of the association.

In my opinion, a national banking association may establish in the city or place designated in its certificate of organization an office or offices for the transaction of business of a routine character, which does not require the exercise of discretion, and which may be legally transacted by the bank itself. It may not, however, establish a branch bank to do a general banking business such as is usually done by national banks. The establishment of such a branch would be illegal, and subject the offending bank to the forfeiture of its charter. 29 Op. 81.

It seems to be the intent of the National Banking Act that the business of banking ordinarily transacted by a national banking association shall be performed in the city or place designated in its organization certificate.

It has been held that a national bank can not make a valid contract for the cashing of checks upon it, at a different place from that of its residence through the agency of another bank. Armstrong v. Second Nat'l Bank, 38 Fed. 883, 886.

While national banking associations may exercise all the powers expressly given them by the statute, and such additional powers as may be necessary to carry on the business of banking, the manner in which the powers may be exercised are subject to the supervision of the Comptroller of the Currency. Should the comptroller, in the exercise of his supervisory powers over national banks, ascertain

that the directors or officers have knowingly violated, or are violating the national banking laws, he may proceed against such association, its officers, and directors as provided by section 5239, R.S., which reads as follows:

"If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this Title, all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper circuit, district, or territorial court of the United States, in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation."

Answering your specific questions I have the honor to advise you as follows:

First. National banking associations have the power to open and operate offices at places other than their banking houses, within the place specified in their organization certificate, for the performance of such routine services as the receipt of deposits and the cashing of checks for their customers.

Second. National banking associations have no authority to open offices for the purpose of receiving deposits, paying checks, etc., outside of the limits of the city or place designated in the organization certificate as the place of its operation of discount and deposit.

Respectfully,

HARRY M. DAUGHERTY.[1]

To the Secretary of the Treasury.

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1 34 Op. Atty. Gen'l.

REGULATIONS OF THE COMPTROLLER OF THE CURRENCY RELATING TO ESTABLISHMENT OF ADDITIONAL OFFICES BY NATIONAL BANKS.

October 26, 1923

"1. Under the authority of the National Bank Act, as construed by the Attorney General in opinions rendered on May 11, 1911, and Oct. 3, 1923, respectively the Comptroller of the Currency will permit national banks, under the conditions hereinafter set forth, to establish one or more additional offices.

"2. A national bank will be permitted to establish such an office only in a city in which other banks are engaged in, and under existing law or regulation are permitted to engage **de novo** in, banking practices which make it necessary for the national bank in question to operate such an office in order effectively to conduct its banking business.

"3. National banks will be permitted to establish such offices only within the limits of the city, town or village named in its organization certificate as the place where its operations of discount and deposit are to be carried on.

"4. A national bank desiring to establish and to operate one or more additional offices shall make application therefor to the Comptroller of the Currency on a form prescribed or approved by him in which shall be set forth, among other things, the following:

(a) The number of offices and the proposed street location or vicinity of each.

(b) A statement of the condition of the applying bank as of the date of application.

(c) The number of banks with branches or additional offices in operation in said city.

(d) A statement of the facts and conditions which, in the opinion of the board of directors make it necessary for the applying bank to establish the proposed office or offices.

"5. Each application for one or more additional offices shall be accompanied by a certified copy of a resolution of the board of directors showing that such application has been submitted to and approved by the board.

"6. After the Comptroller has approved the application of a national bank for one or more additional offices, and before such office or offices are opened for business, a statement shall be transmitted to the Comptroller showing the street location, the purchase price paid, the annual rental cost, and the cost of equipment for each such office.

"7. Operations of additional offices of national banks established under these regulations shall be confined to the receipt of deposits and the payment of checks and other such routine or administrative functions.

"8. No investment in bonds or other securities for the account of the bank shall be made at any such additional office.

"9. No loan or discount shall be made to any customer of the bank through any such additional office that has not been authorized **at the banking house** by a resolution of the board of directors, or by an appropriate committee of such board, or by an officer or officers acting under authority from such board, and no general authority issued by the board of directors shall vest it in any officer or employee at such additional office any discretionary authority with reference to making such loans or discounts.

"10. A statement of the business conducted at such offices shall be transmitted to the banking house as of the close of business daily, shall be incorporated on the books at the banking house at regular intervals, and shall enter into all statements of the condition of the bank."

BANK SUSPENSIONS IN MONTANA FROM 1921 TO 1929 AS REPORTED IN HEARINGS BEFORE THE COMMITTEE ON BANKING AND CURRENCY, HOUSE OF REPRESENTATIVES, SEVENTY-FIRST CONGRESS, SECOND SESSION, UNDER H. RES. 141, FEB. 25, 26, AND 27, 1930, VOL. I, PART 1, PP. 361-364.

First Congressional District

Augusta	1	Hot Springs	1	Stevensville	1
Butte	1	Libby	1	Thompson Falls	1
Charlo	2	Manhattan	1	Three Forks	2
Corvallis	1	Missoula	1	Totson	1
Culbertson	2	Montague	1	Townsend	1
Darby	1	Ovanda	1	Twin Bridges	1
Dixon	1	Pablo	1	Valier	1
Drummond	1	Philipsburg	1	Virginia City	1
Eureka	1	Plains	1	Whitefish	1
Gilman	1	Plentywood	3	Wibaux	2
Glasgow	2	Polson	2	Willow Creek	1
Helena	2	Ronan	1		
				Total	43

Second Congressional District

Absarokee	1	Galata	1	Madoc	1
Antelope	1	Gardiner	1	Malta	1
Baker	3	Genou	1	Martinsdale	1
Ballantine	1	Geraldine	1	Medicine Lake	2
Barber	1	Geyser	1	Melstone	1
Bearcreek	2	Gilford	1	Miles City	2
Belmont	1	Grassrange	1	Moore	2
Belt	1	Great Falls	4	Musselshell	1
Benchland	1	Hardin	2	Nashua	1
Big Sandy	2	Harlowton	1	Neihart	1
Billings	2	Havre	3	Oswego	2
Bowdoin	1	Hedgesville	1	Poplar	3
Box Elder	1	Highwood	1	Rapelje	1
Broadview	2	Higler	1	Ringling	1
Brockway	1	Hingham	2	Rosebud	1
Browning	1	Hinsdale	1	Roundup	3
Buffalo	1	Hobson	1	Roy	2
Carlyle	1	Homestead	1	Rudyard	2
Carter	2	Huntley	1	Ryegate	2
Chester	2	Hysham	1	Saco	2
Circle	1	Ingomar	1	Sandcoulee	1
Clydepark	2	Intake	1	Savoy	1
Coburg	1	Inverness	1	Shawmut	1
Coffee Creek	1	Ismay	1	Shelby	2
Columbus	1	Joliet	1	Shepherd	1
Conrad	1	Joplin	2	Sidney	2
Cut Bank	3	Jordan	2	Stockett	1
Denton	2	Judith Gap		Sumatra	1
Devon	1	Kremlin	2	Sweetgrass	3
Dodson	1	Lambert	2	Vananda	1
Edgar	1	Laurel	3	Westmore	1
Fallon	1	Lavina	1	Wilsall	2
Fairfield	1	Lehigh	1	Windham	1
Fairview	2	Lewistown	2	Winifred	1
Forsyth	3	Livingston	3	Winnett	1
Fort Benton	2	Lodge Grass	1	Wolf Point	2
Fresno	1	Loma	1		
				Total	160

July, 1930 AMERICAN BANKERS ASSOCIATION JOURNAL

THE NEEDS OF BANKLESS TOWNS

By A. J. Veigel

Commissioner of Banks, State of Minnesota

There are 154 villages in Minnesota, which ten years ago had one or more banks, but which are without a bank at this time. Some of these banks were closed and many were taken over by neighboring banks in larger cities. We believe similar conditions exist in other states.

Most of these villages are not large enough to support an independent bank, but many of them are entitled to some banking services. Banking laws should be drawn, if possible, so as to give the public adequate and convenient banking services, and at the same time have all banks large enough so they can employ competent officials and have sufficient capital and earnings so they will be safe depositories.

About one-half of these 154 villages in Minnesota, which are now bankless, should have some kind of banking service. It is a severe blow to a community to be without a bank. People who would ordinarily go to such villages to do their buying and selling will probably trade at some other place where there is a bank. The result is that property value depreciates and they gradually lose out.

We do not believe that it is in the interest of our country that the population should be further centered in the large cities at the expense of these small communities. While we realize that automobiles and good roads have doomed many of these small villages, we believe there are others which can and will survive if given banking facilities.

When conditions get better, there will undoubtedly be numerous new applications for banks in many of these villages. If charters are granted for independent banks—and it is not easy to deny them where a community is so vitally interested—we will again invite a repetition of the bank troubles we have had in the past times of stress.

In view of these conditions, we have been seriously considering recommending to the legislature that a law be enacted permitting one branch bank in a village which does not have any bank or in which the existing bank voluntarily desires to become a branch of a larger bank. No bank could start a branch more than twenty miles from the main office.

We do not believe that the existing banks would oppose a law of this kind, because a branch could never be established except in a town or village where there was no bank at present, or if there were a bank, they would voluntarily have to ask to become a branch and could not be forced to do so.

A bank should have at least $25,000 capital to have one branch and at least $5,000 additional for each new branch. Most of such branches would probably have a teller who would receive deposits and pay checks and the loans would be passed on and handled almost entirely at the main office. Such a branch would be much less expensive than an independent bank, because it would not require the independent capital, would not have to pay the high taxes on its capital and surplus and would not require a high salaries officer to operate, because nearly all of the executive work could be done by the officers in the main office.

The proposed law is suggested not primarily in the interest of banks, but in the public interest of the people in these communities.

This office is not in favor of a general branch bank law. We believe our independent banks have performed a useful service in the past and will continue to do so. By having these branches limited to a radius of about twenty miles from the main office, they will still be local independent banks and could not be controlled by larger banks to the extent which would be possible if a general branch bank law were enacted.

We believe that the great strength of our country is due largely to the so-called middle class of citizens who are fairly well off. We also believe that our independent banks have had more to do in creating and maintaining this independent middle class than any other agency. It would seem desirable, therefore, to keep this local control of the banks and at the same time give these bankless towns banking services.

The law should carefully guard the establishment of such branches. Applications should be made to the securities commission the same as applications for a new bank charter. Not more than one branch should be permitted in any village and none where there are one or more independent banks.

If a law is passed in any state and proves desirable, Congress would undoubtedly amend the national bank act to give national banks the same privilege.

We believe this subject is entitled to serious consideration and discussion with the end in view of finding some way adequately to serve the public without at the same time inviting a repetition of the small bank trouble of the past, or of having local banks owned and controlled from distant large cities.

SUMMARY OF STATE LAWS RELATIVE TO BRANCH BANKING AS OF 1932, FROM **FEDERAL RESERVE BULLETIN**, JULY 1932, P. 455, AND REPORT OF THE FEDERAL RESERVE COMMITTEE ON BRANCH, GROUP AND CHAIN BANKING, ENTITLED **BRANCH BANKING IN THE UNITED STATES**, FEDERAL RESERVE LIBRARY H.G. 1617, U.1, VOL. 2, PP. 181-210.

States Permitting State-wide Branch Banking	States Prohibiting Branch Banking	States Having No Legislation Regarding Branch Banking
Arizona	Alabama	Kentucky
California	Arkansas	Michigan
Delaware	Colorado	New Hampshire
Maryland	Connecticut	North Dakota
North Carolina	Florida	Oklahoma
Rhode Island	Idaho	South Dakota
South Carolina	Illinois	Wyoming
Virginia	Kansas	
	Minnesota	
	Missouri	
	Montana (1)	
	Nebraska	
	Nevada	
	New Mexico	
	Oregon	
	Texas	
	Utah	
	Washington	
	West Virginia	

States Permitting Branch Banking In Limited Areas	States Permitting Limited Banking Activities Outside of Principal Office	States Permitting Retention of an Office After Consolidation
Georgia	Vermont (agencies) (3)	Montana (1)
Indiana	Iowa (4)	
Louisiana	Wisconsin (2)	
Maine		
Massachusetts		
Mississippi		
New Jersey		
New York		
Ohio		
Pennsylvania		
Tennessee		

(1) Montana specifically prohibited any "branch banks" by 1927 statute. By a separate 1931 statute, Montana allowed maintenance of an "office" after the consolidation of two banks in the same or adjoining counties.

(2) Wisconsin, by 1932 statute, authorized the establishment of "receiving and disbursing stations," similar to "offices" in Iowa.

(3) Vermont, by 1929 statute, permitted "agencies."

(4) Iowa, by 1927 statute absolutely prohibited branch banks. By 1931 **amendment** banks were allowed to "establish an office for the sole and only purposes of receiving deposits and paying checks and performing such other clerical and routine duties not inconsistent with this act."

Senate Report No. 2040, Sept. 13, 1962
[To accompany H.R. 12899]

House Report No. 2256, Aug. 20, 1962
[To accompany H.R. 12899]

The Senate Report is set out.

Senate Report No. 2040

The Committee on Banking and Currency, to whom was referred the bill (HR. 12899) to amend section 5155 of the Revised Statutes, relating to bank branches which may be retained upon conversion or consolidation or merger, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF THE BILL

H.R. 12899 would amend subsection (b) of section 5155 of the Revised Statutes. Under this subsection in conjunction with other provisions of existing law, when a bank converts from a State to a National charter, it must give up any of its branches established after February 25, 1927, unless such branches can be newly established under State law at the time of conversion. This is a result which is brought about by Federal law and not by State law. In other words, the Federal law precludes the coverage by State grandfather clauses of branches established after February 25, 1927.

The bill would change this by permitting the same branch retention privileges to a bank converting from a State to a National charter as the law of the State permits to a bank converting from a National to a State charter, except that in any given instance the retention of a branch established after February 25, 1927, would be subject to the approval of the Comptroller of the Currency.

A similar situation obtains with respect to consolidations. Under existing law, a national bank must close any branch established after February 25, 1927, when the national bank consolidates with any other bank, unless the branch in question could, under State law, be newly established at the time of the consolidation. The bill would permit the retention, with the approval of the Comptroller of the Currency, of any branch of the bank under whose charter the consolidation is carried out, provided that a State bank carrying out a similar consolidation would not be prohibited from retaining a similar branch. The bill would also define "consolidation" to include a merger, as the practical effect of the two is the same.

GENERAL STATEMENT

The existing law as to retention of branches in cases of conversion, consolidation, or merger operates as a deterrent to State banks converting into National banks in certain States, and hence is inconsistent with the dual banking system, which contemplates that State banks should be able to convert freely into National banks and vice versa. The bill, as in the case with existing law, would have no application in those States which have unlimited branch banking, or in those States where branch banking is prohibited. Its effect would be felt only in States which permit a limited form of branch banking, and which at one time had more liberal branch laws than at present, or in which because of intervening factual changes, existing branches could not be reestablished. In such States, upon conversion, consolidation, or merger, a bank may have to give up all of its branches acquired since February 25, 1927.

The purpose of the existing law is to prevent a bank from acquiring branches by taking over other banks where such branches could not legally be established under State law. However, this purpose does not apply to branches of a bank under whose charter a consolidation is carried out, and no public interest is served by requiring such a bank to give up its legally established branches already in existence.

The bill would remove this inequality to our national banks without departing from the purpose of the existing law. It would permit the retention of those legally established branches of the national bank under whose charter the merger or consolidation is being effected, subject to the approval of the Comptroller, and subject to the absence of provisions in the appropriate law of the State which would deny retention in identical circumstances where the resulting bank is a State bank. In so doing, it would preserve the existing permission for the retention of all branches of the banks whose charters will cease to exist by the merger or consolidation, and the retention of their main offices, if such branches could be established on original application under the law of the State at the time of the merger or consolidation.

Hearings were held on R.H. 12899 on August 30, 1962. The three Federal bank supervisory agencies, the American Bankers Association, and the National Association of Supervisors of State Banks supported the bill. No opposition was expressed.

Exhibits

Number of Letter	Description	References to Record (Tr. of Proceedings, August 7, 8, 1967)	
Pls'. No. 1	Montana Atty. Genl's Opinion	Admitted	5
Pls'. No. 2	Statement in Opposition to H. B. 509	Admitted	8
Pls'. No. 10	Application to Comptroller by Intervenors to Consolidate and Branch	Admitted	23
Pls. No. 11	Consolidation Agreement Among Intervenors and Northwest Bancorporation	Admitted	27
Pls. No. 12	Fed. Res. Report to Comptroller, attached to Pls. Exh. 10	Admitted	224
Defs. Exh. A	Copy of H. B. 205	Admitted	8
Defs. Exh. B	Copy of Pl. Leuthold Testimony Before Montana Legislature on H. B. 509	Admitted	8
Defs. Exh. C	Certified Copy of H. B. 509	Admitted	8
Defs. Exh. D	1931 Newspaper Account	Refused	212
Defs. Exh. E	1931 Newspaper Account	Refused	212
Defs. Exh. F	Decision of Comptroller on Consolidation	Admitted	220
Defs. Exh. G	Dept. of Justice Report to the Comptroller	Admitted	221

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22202

ALBERT E. LEUTHOLD, SUPERINTENDENT OF BANKS, STATE OF MONTANA, HELENA, MONTANA, SECURITY BANK AND MINERS BANK OF MONTANA, N. A.

Appellants

VS.

WILLIAM B. CAMP, COMPTROLLER OF THE CURRENCY

Appellee

THE FIRST NATIONAL BANK OF BUTTE AND DALY NATIONAL BANK OF ANACONDA

Intervenor-Appellees

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA, BUTTE DIVISION

BRIEF OF INTERVENOR-APPELLEES

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333-3539 Hayward-Court Brief Prtg. Co., Mpls., Minn. 55415 333-3530

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JURISDICTION

The District Court concluded in its opinion and order (R. 54; Appendix B to this brief) that this action embodied a challenge to a decision of the Comptroller of the Currency with respect to branch banking and that it therefore gave rise to jurisdiction under the *Administrative Procedure*

Act, 5 U.S.C. 1001, *et seq.* (now 5 U.S.C. 701, *et seq.*). Intervenors contended below and still contend (see parts III.A. and III.B. of this brief) that appellant Leuthold lacked standing to sue and that the District Court lacked jurisdiction over appellants' claim under the *Bank Holding Company Act of 1956*.

The judgment below having been entered on November 8, 1967, *nunc pro tunc* as of August 29, 1967, this Court has jurisdiction pursuant to *28 U.S.C.* 1291.

QUESTIONS PRESENTED

1. Was the District Court correct in concluding that appellants failed to state a claim under the National Bank Act?

2. Was the District Court correct in concluding that appellants failed to state a claim under the Bank Holding Company Act?

3. Did appellant Leuthold lack standing to sue?

4. Did the District Court lack jurisdiction over appellants' claim under the Bank Holding Company Act?

5. Was appellants' attempted showing of irreparable injury inadequate to support injunctive relief?

6. Should injunctive relief be withheld in the public interest?

7. Should injunctive relief be withheld because of the doubtful nature of its effect?

STATUTES INVOLVED

12 U.S.C. 36(b)(2), the National Bank Act:

"A national bank (referred to in this paragraph as the 'resulting bank'), resulting from the consolidation of a national bank (referred to in this paragraph as the 'national bank') under whose charter the consolidation is effected with another bank or banks, may retain and operate as a branch any office which, immediately prior to such consolidation, was in operation as—

(A) a main office or branch office of any bank (other than the national bank) participating in the consolidation if, under subsection (c) of this section, it might be established as a new branch of the resulting bank, and if the Comptroller of the Currency approves of its continued operation after the consolidation;. . . ."

12 U.S.C. 36(c), the National Bank Act:

"A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: . . . (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks. . . ."

12 U.S.C. 1842(a), the Bank Holding Company Act of 1956:

"(a) It shall be unlawful, except with the prior approval of the Board, . . . (4) for any bank holding

company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; . . . ."

12 U.S.C. 1842(d), the Bank Holding Company Act of 1956:

"(d) Notwithstanding any other provision of this section, no application shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted on July 1, 1966, or the date on which such company became a bank holding company, whichever is later, unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication. . . ."

12 U.S.C. 1847, the Bank Holding Company Act of 1956:

"Any company which willfully violates any provision of this chapter, or any regulation or order issued by the Board pursuant thereto, shall upon conviction be fined not more than $1,000 for each day during which the violation continues. . . ."

Section 5-1028, Revised Codes of Montana (1947):

"No bank shall maintain any branch bank, receive deposits or pay checks, except over the counter of and in its own banking house. Provided, that nothing in this section shall prohibit ordinary clearing house transactions between banks. . . ."

Section 5-1124, Revised Codes of Montana (1947):

"When any two or more banks located in the same county or in adjoining counties shall consolidate in accordance with the provisions of section 5-1021, the consolidated bank may, if it has a paid up capital of seventy five thousand dollars ($75,000.00) or more, upon the written consent of the superintendent of banks and under rules and regulations promulgated by him, maintain and operate offices in the locations of the consolidating banks."

Chapter No. 72, Montana Session Laws, 1967:

Section 1. Any state or national bank, banking corporation, or private bank, the stock, moneyed capital, or moneys and credits of which are subject to taxation under the provisions of chapter 3 and chapter 46, title 84, Revised Codes of Montana, 1947, and which has banking offices in more than one (1) county, shall furnish to the assessor of each such county the information required of it by chapter 46, title 84, Revised Codes of Montana, 1947, together with a statement of the book value of real estate owned and located in the respective counties and a statement of the deposit liability shown by the books of account of said bank at each of its said banking offices at the close of business the day next preceding the first Monday in March; and the aggregate tax on the stock, moneyed capital, and moneys and credits of such bank computed as provided by law shall be assessed by and be paid to the respective counties in the proportion which the amount of the deposit liability shown on the books of the office or offices of such bank located in such counties, respectively, shall bear to the total deposit liability of such bank.

Section 2. All acts and parts of acts in conflict with this act are hereby repealed.

Section 3. This act shall be in full force and effect from and after its passage and approval.

STATEMENT OF THE CASE

The nature of the case is accurately described in the first four paragraphs of the opinion and order of the District Court (R. 54), a copy of which is attached hereto for the convenience of this Court as Appendix B.

When the District Court denied all relief to the plaintiffs, they filed a notice of appeal and moved for an injunction pending appeal to restrain the Comptroller from approving the application for consolidation. Both the District Court and this Court denied plaintiffs' motions. Thereafter, the Comptroller approved the consolidation, it was accomplished, and the resulting bank, First National Bank, now operates banking offices at Butte and Anaconda.

SUMMARY OF ARGUMENT

Under Section 36 of the National Bank Act, *12 U.S.C.* 36, a national bank may, with the approval of the Comptroller, operate a branch if state banks in that state are authorized to do so by state statute law. In Montana, RCM 5-1124 permits a state bank to branch pursuant to a consolidation. Therefore the resulting bank may branch pursuant to the consolidation of intervenor banks. The District Court was thus clearly correct in concluding that appellants failed to state a claim under the National Bank Act.

The Bank Holding Company Act provides, in *12 U.S.C.* 1842(a), that it shall be unlawful, except with prior approval of the Federal Reserve Board, for any bank holding company or subsidiary thereof, "other than a bank," to acquire the assets of a bank. The phrase "other than a bank"

removes from the restrictions of the act the acquisition of the assets of the First of Butte by the Daly. The District Court was therefore clearly correct in concluding that appellants failed to state a claim under the Bank Holding Company Act.

The National Bank Act is federal law and it contains no provision for enforcement by a state official. The Bank Holding Company Act is also federal law, and it was intended to be enforced solely by federal criminal prosecution. Appellant Leuthold, a state official, therefore lacked standing to enforce either statute.

Because the exclusive method of enforcement of the Bank Holding Company Act is federal criminal prosecution, the District Court lacked civil jurisdiction over appellants' claims under that statute.

An injunction—particularly an injunction against the performance of duty by a public official—will not issue except upon a clear showing of irreparable injury. Appellants' evidence on injury in this case was speculative, conjectural, confused, self-contradictory, and unreliable. Intervenors presented clear and convincing evidence of lack of probable irreparable injury. Thus, no factual foundation for injunctive relief was established.

There is a strong public interest in banking competition. A court of equity should withhold injunctive relief when such action will serve the public interest. Here the facts show that the consolidation of intervenor banks will benefit the public of Butte. The injunction sought by appellants would therefore be inappropriate.

A court of equity will not issue an injunction of doubtful effect. In this case, appellants really seek to prevent not the proposed consolidation but, rather, an invigoration of

banking competition in Butte. Such an increase in competition may occur even if the proposed consolidation does not. Therefore, the requested injunction should not issue.

ARGUMENT

I.

THE DISTRICT COURT CORRECTLY HELD THAT APPELLANTS FAILED TO STATE A CLAIM UNDER THE NATIONAL BANK ACT.

The District Court held that the consolidation and operation of the intervenor banks is permitted by the provisions of the National Bank Act. Appellants' quarrel with this conclusion is set out in parts A and B of their brief, which are considered in order below.

A. Section 36(c) of the National Bank Act does not Prohibit the Maintenance of a Branch Bank after Consolidation of the Intervenor Banks.

The gist of appellants' argument under Section 36(c) of the National Bank Act, *12 U.S.C.* §36(c), is as follows: Under the provisions of that paragraph, a national bank may establish and operate branches, with the approval of the Comptroller of the Currency, if state banks in that state are authorized to do so by state law. Under the Revised Codes of Montana, 1947 (hereinafter referred to as "RCM"), Section 5-1028, state banks are prohibited from operating branches. Therefore, if the banks here in question consolidate, they may not operate a branch in Butte. This argument errs for the following reasons.

1. The statute law of Montana affirmatively authorizes the establishment of a branch by a state bank fol-

lowing consolidation. RCM Section 5-1028, which generally prohibits branch banking by Montana state banks, has been in effect since the 1927 codification of the Montana banking statutes by Chapter 89 of the *Laws of 1927,* in which this provision appeared as Section 101. Subsequently, there was enacted as Section 1 of Chapter 129, *Laws of 1931,* a provision now appearing as RCM Section 5-1124, which reads as follows:

> "When any two or more banks located in the same county or in adjoining counties shall consolidate in accordance with the provisions of Section 5-1021, the consolidated bank may, if it has a paid up capital of seventy-five thousand dollars ($75,000 00) or more, upon the written consent of the superintendent of banks and under rules and regulations promulgated by him, *maintain and operate offices in the locations of the consolidating banks.*" (Emphasis added.)

Section 2 of Chapter 129 provides: "All Acts and parts of Acts in conflict herewith are hereby repealed." This express repealer makes it clear that Section 5-1124 modifies, and was intended by the Montana Legislature to modify, the general prohibitory language of RCM Section 5-1028.

But even in the absence of such repeal provision, Section 5-1124, being both the later and the specific provision, would prevail in the situation to which it refers. For RCM Section 93-401-16, which has been the law in Montana since 1877, provides as follows:

> "In the construction of a statute the intention of the legislature, and in the construction of the instrument the intention of the parties, is to be pursued if possible; and when a general and particular provision are inconsistent, the latter is paramount to the former. So

> a particular intent will control a general one that is inconsistent with it."

In *Story Gold Dredging Co. v. Wilson,* 106 Mont. 166, 175, 76 Pac. 2d 73, 78 (1938), the Montana Supreme Court said:

> "We have said in the case of Durland v. Prickett, 98 Mont. 399, 39 P. 2d 652, 656: 'In the case of Langston v. Currie, 95 Mont. 57, 26 P. 2d 160, 163, this court said: "Where there is one statute dealing with a subject in general and comprehensive terms, and another dealing with a part of the same subject in a more minute and definite way, the two should be read together and harmonized, if possible, with a view to giving effect to a consistent legislative policy; but, to the extent of any necessary repugnance between them, the special will prevail over the general. State ex rel Daly v. Dryburgh, 62 Mont. 36, 203 P. 508." This rule is applicable here, and accordingly section 6825 is of no controlling force as applied to the facts in this case . . .' "

This, of course, is the answer to Opinion No. 23, Volume 31 (Sept. 29, 1966), of the *Opinions of the Attorney General of Montana* (Pl. Ex. No. 1), which concludes that RCM Section 5-1124 cannot be read to permit establishment of branches by consolidated banks because that would produce a conflict with RCM 5-1028. There is no conflict between these two statutes for the simple reason that Section 5-1124 constitutes a partial amendment of Section 5-1028. The two, taken together, harmonize to prohibit branch banking in Montana *except* pursuant to a consolidation.

There is no reason to suppose that RCM Section 5-1028 is immune to the sort of amendment which RCM Section

5-1124 in fact effected. Indeed, RCM Section 5-1028 was also amended by Chapter 39, *Laws of 1963*, and Chapter 80, *Laws of 1965*. The former established rules for the operation of detached drive-in and walk-up facilities by state banks, and the latter amended the former with respect to the rules governing distances between these special facilities and other facilities or banks.

It is therefore clear that the Montana law on branch banking is no longer the simple prohibition that it was in 1927. Rather, it is a general prohibition subject to an exception in the case of bank consolidations and a further exception for drive-in and walk-up facilities. (It cannot be argued that the legislature reenacted the original prohibitory provisions of RCM 5-1028 in enacting the 1963 and 1965 amendments, because, under RCM Section 43-510, a statute is not deemed to have been repealed and reenacted in amended form, but, rather, the unamended portion is considered to have been law from the date of its enactment and only the new provisions are considered to have been enacted at the time of amendment.)

2. The Attorney General's opinion, mentioned above, seeks to avoid these conclusions by reliance on the word "offices" in RCM 5-1124. It suggests that the consolidated bank may operate separate "offices," but no such office can serve as a branch for the purpose of engaging in the banking business.

We have already shown that it is not necessary to resort to this strained construction, for RCM Section 5-1028 and RCM Section 5-1124 harmonize without difficulty when the word "offices" is construed to include branches. And there is no reason why the terms "office" and "branch" must be considered mutually exclusive. For ex-

ample, the national bank branching statute, *12 U.S.C.* Section 36(f), in defining "branch," has, since its original enactment in 1927, included the terms "branch office" and "additional office." Further, Section 36(b) of *12 U.S.C.*, on which appellants rely, speaks of the operation of branches by a consolidated bank at the "main office" or "branch office" of a bank participating in the consolidation. Obviously, the concept of "office" includes the concept of "branch" in common banking practice.

If the Montana Legislature had intended in RCM Section 5-1124 to authorize only offices not performing banking functions, it could readily have written an express limitation to that effect. This was demonstrated when the Legislature enacted Chapter 39, *Laws of 1963*, authorizing drive-in and walk-up facilities in language that explicitly limits the functions of such facilities to receiving deposits, cashing checks, receiving payments, and other transactions usually handled at tellers' windows By contrast, in RCM Section 5-1124 the Legislature not only omitted any such limitation, but authorized the consolidating banks to operate "offices" at the "locations" of the consolidated bank. At least one such "location" will, of course, be the main banking "office" of any such consolidated bank.

It necessarily follows that the term "office," as used in RCM Section 5-1124, includes a place where general banking services are offered to the public. It further follows that permission to operate "offices" at the "locations" of the consolidating banks constitutes permission to provide general banking services at all such locations, for the statute contains no language to provide a basis for distinguishing the main banking "office" of the consolidated bank from any other of its "offices."

Appellants fail to deal with this argument. They contend at length (App. Br. 13-23) that the word "office" may on occasion mean something less than the word "branch" when applied to a bank. This argument is self-defeating. As indicated above, when the Montana Legislature has wished to describe a banking facility of limited scope, it has shown itself perfectly capable of doing so in explicit language. And, in other states, when a legislature has wished to limit the powers of a banking "office" it has done so explicitly and by definition. (See, *e.g.*, App. Br. 22.) The Montana Legislature incorporated no such limited definition of "office" into Section 5-1124. (The Court is referred to that portion of the District Court's opinion (Appendix B hereto) which follows the heading "The National Bank Act" for a discussion of this question which, to intervenors, seems unanswerable.)

Intervenors suggest further that most of this portion of appellants' argument is not properly before this Court. It is a familiar principle that an appeal must be decided solely upon the evidence actually produced in the court below. See, *e.g.*, *Moose v. Vesey*, 225 Minn. 64, 67, 29 N. W. 2d 649 (1947), and authorities cited therein. Appendix G to appellants' brief sets forth the exhibits introduced at the trial of this case. Appendices A through F of appellants' brief contain a variety of other exhibits. Not one of these is listed in Appendix G because not one was offered to the court below. All would have been open to objection on the grounds of relevance, authenticity, hearsay, and the like. Yet this Court is now asked to base its decision in part upon them. Under the rule stated above, this is clearly inappropriate.

Appellants have sought to introduce these items of evi-

dence into this appeal in an effort to shore up their argument that history supports their construction of the law. This historical argument (see, *e.g.*, App. Br. 16-20) is wildly speculative and conjectural. It relies on evidence never placed before the trial court. It assumes knowledge and attitudes on the part of Montana legislators which are impossible to substantiate. It conjures up a pseudo-legislative history to stand in place of a legislative history which appellants cannot possibly document. And, ironically, it lends more support to intervenors than to appellants, for it spotlights the fact that while some people were thinking of defining "office" to mean less than "branch," the Montana Legislature was omitting to enact any such narrow definition.

In contrast, intervenors actually introduced newspaper articles (D. Exs. D and E) into evidence to show that Section 5-1124 was thought at the time of its enactment to authorize the operation of branches upon consolidation. The trial court excluded these exhibits from evidence (Tr. 212), despite ample authority supporting their admissibility. See, *Dallas County v. Commercial Union Assur. Co.*, 286 F. 2d 388 (5th Cir. 1961); *Montana Power Co. v. Federal Power Comm'n*, 185 F. 2d 491 (D.C. Cir. 1950), *cert. denied* 340 U. S. 947 (1951), *reh. denied* 341 U. S. 912. These admissible newspaper accounts lend additional support to the District Court's conclusion that in Section 5-1124 the word "offices" means "branches."

3. It is therefore abundantly clear that, in Montana, consolidating banks may operate banking branches at their pre-existing locations. Any question on this count was laid to rest by the Montana Legislature at its most recent session. There, on January 21, 1967, a bill (House Bill

No. 509; D. Ex. C) was introduced to repeal RCM Section 5-1124.

Appellant Albert E. Leuthold testified in support of this repeal bill. In his prepared testimony (D. Ex. B) Mr. Leuthold vigorously urged that the proposed consolidation of the intervenor banks was an attempt to establish branch banking, that it would lead to a rash of consolidations, that it would lessen competition in Montana banking, and that approval of H.B. 509 would resolve this situation. He professed to believe, further, that Section 5-1124 was a special depression measure the need for which had expired, that by their reliance upon it these intervenors were "circumventing our laws" and engaging in "illegal action," and that it would lead to a "rash of consolidations." He added, "If the legislature kills H.B. 509 or does nothing about it, it will have a bearing on the pending court case."

In the face of these arguments and dire predictions, *the Legislature killed H.B. 509 on February 1, 1967,* and left Section 5-1124 in force.

It is axiomatic that the paramount rule of statutory construction is that the intention of the legislature is to be given effect. *Doull v. Wohlschlager,* 141 Mont. 354, 377 P. 2d 758 (1963); *Fulton v. Farmers Union Grain Terminal Association,* 140 Mont. 523, 374 P. 2d 231 (1962). Legislative intent can be shown not only by action but by deliberate refusal to act. For example, in *Board of Education v. Public School Employees' Union,* 233 Minn. 144, 45 N. W. 2d 797 (1951), the court held that the repeated introduction and defeat of legislation to prohibit strikes by public employees indicated that the legislators did not believe that existing legislation prohibited such strikes. And in *American Bridge Co. v. Smith,* 352 Mo. 616, 179 S. W. 2d

12 (1944), *cert. denied,* 323 U. S. 712, the court held that the repeated failure of the legislature to amend a tax statute to give it the meaning urged by one of the parties indicated that the legislature did not intend it to have that meaning.

This approach to statutory construction is firmly fixed in Montana law. In *Bottomly v. Ford,* 117 Mont. 160, 167-168, 157 P. 2d 108, 112 (1945), the Montana Supreme Court stated:

> "Generally, of course, legislative intent is indicated by its action rather than by its failure to act. 'On the other hand, it has been declared that the silence of the legislature, when it has authority to speak, may sometimes give rise to an implication as to the legislative purpose, the nature and extent of that implication depending on the nature of the legislative power and the effect of its exercise. . . .' "

Thus, when the legislature had expressly been requested to change the rule of a Montana Supreme Court decision, but had defeated measures introduced to effect such change, the court held that there was "no logical way" of interpreting its actions otherwise than as "approval and confirmation" of the case sought to be overruled (117 Mont., at 169, 157 P. 2d, at 113).

More recently, the Montana Supreme Court considered this matter in *James v. V. K. V. Lumber Company,* 145 Mont. 466, 401 P. 2d 282 (1965). In that case, the Court found itself faced with the problem of legislation introduced to change the definition of the word "injury" under the Montana Workmen's Compensation Act and recognized the legislative attempt to change the definition of "injury" by stating as follows:

> "Since our decision in the Lupien case, the Thirty-ninth Legislative Assembly has met. We note that at least three bills were introduced in the Senate, Senate Bills Nos 94, 48 and 206, each of which had as their purpose a change in the definition of injury contained in section 92-418. Senate Bill No. 94, as introduced, would have changed the definition, but later was amended and enacted into law, re-enacting section 92-418 just as it was when the Lupien case was decided; Senate Bill No 48 and Senate Bill No. 206 would have redefined injury; Senate Bill No. 206 would have included 'strains' in the definition. Both measures were killed. Thus, we have a legislative consideration of the very definition involved."
>
> "For the foregoing reasons the judgment of the district court is reversed." 401 P. 2d, at 283.

The *James* case, being the most recent pertinent expression of the view of the Montana Supreme Court, is binding upon a federal court applying Montana law. See, *Vandenbark v. Owens-Illinois Glass Co.,* 311 U. S. 538, 543 (1941). Further, the *Bottomly* conclusion is necessitated here. Once the proponents of H.B. 509 had urged, as did appellant Leuthold, that defeat of that bill would lead to branch banking via bank consolidation in Montana, and the Legislature had deliberately killed H.B. 509, there became "no logical way" of interpreting this legislative action otherwise than as "approval and confirmation" of the interpretation of RCM Section 5-1124 which H.B. 509 was intended to eradicate. Mr. Leuthold expressly warned the Legislature that rejection of H.B. 509 would have a bearing on the present case; the Legislature nonetheless rejected it. Surely a clearer expression of legislative intent would be difficult to find.

4. But the Montana Legislature did not stop here. Rather, it gave even more convincing proof of its interpretation of RCM Section 5-1124 by enacting into law a new taxing statute (Chapter No. 72, Montana Session Laws 1967, House Bill No. 205; (D. Ex. A)), which states that any state or national bank which "has banking offices in more than one (1) county" shall be taxed by the respective counties "in the proportion which the amount of the deposit liability shown on the books of the office or offices of such bank located in such counties, respectively, shall bear to the total deposit liability of such bank." In other words, the Montana Legislature recognized that *some Montana banks may maintain "banking offices" in more than one county and that they may choose to keep customer deposits at each of them.*

There is simply no other way to interpret the action of the Montana Legislature in passing H.B. 205. Legislative intent is "gathered from the terms of the statute considered in the light of the surrounding circumstances." *Veterans' Welfare Commission v. Department of Mont. V.F.W.*, 141 Mont. 500, 506, 379 P. 2d 107, 110 (1963). Here the circumstances show the legislature first refusing to repeal a statute which allows consolidating banks to maintain branches, and then enacting a statute which allocates taxes among deposit-holding banking offices of banks operating in more than one county. Clearly the Legislature (1) read RCM Section 5-1124 to allow the operation of branches by a consolidated bank, (2) confirmed its approval of RCM Section 5-1124 by refusing to repeal it, and (3) established a tax allocation system to cover the multi-branch situation which it interpreted RCM Section 5-1124 to authorize. In Montana, as elsewhere, statutes which relate

to the same general subject matter "should be construed together where there is no inconsistency between them, and effect given to both where this is possible." *State ex rel. Ronish v. School District No. 1 of Fergus County,* 136 Mont. 453, 462, 348 P. 2d 797, 802 (1960). Further, a statute will not be construed as meaningless or a nullity. *Doull v. Wohlschlager,* 141 Mont. 354, 364, 377 P. 2d 758, 763 (1963). " 'Every word, phrase, clause or sentence employed (in a statute) is to be considered and none shall be held meaningless if it is possible to give effect to it.' " *Fletcher v. Paige,* 124 Mont. 114, 119, 220 P. 2d 484, 486 (1950).

All of the foregoing rules of statutory construction would be violated by appellants' urged construction of RCM Section 5-1124, given the recent enactment of H.B. 205. Unless RCM Section 5-1124 is read to permit branch operations by consolidated banks, H.B. 205 becomes a nullity, without effect, and its language becomes meaningless. If it is not possible for banks to maintain "banking offices in more than one (1) county," it is absurd to legislate tax apportionment among counties, as in H.B. 205, according to the proportion of "deposit liability" located in each such county. To avoid construing the passage of H.B. 205 as a useless, even senseless act, it is necessary to conclude that some provision of Montana banking law permits some banks to operate banking offices in more than one county. The only provision that can be construed to give such authority is RCM Section 5-1124. It follows that a consolidated bank can perform banking services at all locations at which the consolidating banks performed such services.

B. Section 36(b)(2) of the National Bank Act Does Not Prohibit the Maintenance of a Branch after Consolidation of the Intervenor Banks.

Appellants' argument as to this aspect of the case can be sustained only by a misreading of the statute which omits one important phrase and overemphasizes another.

1. On page 27 of their brief, appellants direct the court's attention to the following language:

> "(2) A national Bank * * * may retain and operate as a branch * * * A main office or a branch office * * * if, under subsection (c) of this section, *it might be established as a new branch* * * *" (Emphasis added.)

This grossly distorts the true meaning of the statute by omitting after the words "new branch" the words "of the resulting bank." This language renders appellants' attempted paraphrase of the statute (App. Br. 27, 37) patently erroneous. The statute does *not* say that the *acquiring* bank may operate a branch if such branch could be established as a new branch of the *acquiring* bank. Rather, it says that the *resulting* bank (*i.e.,* the bank resulting from the consolidation) may retain and operate as a branch a main or branch office which could be established as a new branch of the *resulting* bank. The distinction is vital because a branch of the *resulting* bank is precisely what RCM 5-1124 authorizes when it permits a "consolidated" bank to maintain offices in the locations of the "consolidating" banks.

An accurate comparison of the relevant portion of the statute with a sound paraphrasing of it demonstrates appellants' error. The statute actually reads, in pertinent part:

"(2) A national bank (referred to in this paragraph as the 'resulting bank'), resulting from the consolidation of a national bank (referred to in this paragraph as the 'national bank') under whose charter the consolidation is effected with another bank or banks, may retain and operate as a branch any office which, immediately prior to such consolidation, was in operation as—

(A) a main office or branch office of any bank (other than the national bank) participating in the consolidation if, under subsection (c) of this section, it might be established as a new branch of the resulting bank, and if the Comptroller of the Currency approves of its continued operation after the consolidation;. . . ."

Substituting the names of the banks involved in this consolidation, we may read:

"(2) First National Bank (the 'resulting bank'), resulting from the consolidation of Daly National Bank of Anaconda (the 'national bank') under whose charter the consolidation is effected with another, bank or banks (*i.e.*, The First National Bank of Butte), may retain and operate as a branch any office which, immediately prior to such consolidation, was in operation as—

(A) a main office or branch office of The First National Bank of Butte if, under subsection (c) of this section, it might be established as a new branch of First National Bank, and if the Comptroller of the Currency approves of its continued operation after the consolidation;. . . ."

Thus, contrary to appellants' contention, the test is not whether the Daly National Bank of Anaconda could estab-

lish a branch in Butte, but whether the "resulting" or "consolidated" bank, *i.e.*, First National Bank, may do so. As intervenors have shown at length, that is exactly what RCM 5-1124 permits.

2. In any event, Section 36(b)(2) has very little bearing on the correct outcome of this litigation. This is so because that section says that the resulting bank may retain and operate a branch "if, *under subsection (c) of this section,* it might be established as a new branch of the resulting bank,. . . ." Hence, we are directed to Section 36(c) for guidance. That section states that:

> "(c) A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: . . . (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition,. . . ."

Thus, we are referred to Montana statute law and, inevitably, to RCM 5-1124. Intervenors have already discussed this statute in great detail. Suffice it here to recall that RCM 5-1124 authorizes a "consolidated" bank to "maintain and operate offices in the locations of the consolidating banks." The requirements of Section 36(c) are therefore satisfied.

Appellants argue that "offices" in RCM 5-1124 does not include "branches" or, at least, that it includes branches only "by implication." The error of this proposition has been exhaustively discussed in Part I.A. of this brief and need not be reconsidered here. As the District Court stated:

> "When the Montana legislature in §5-1124 used the word 'office' without limitation, it specifically granted the authority to engage in banking in two locations under the limitations imposed by the section. The mere fact that the parties and counsel argue to the contrary does not mean that the power to maintain two offices arises by implication or recognition."

Appellants point to the term "new branches" in Section 36(c) and argue that no Montana statute authorizes "new branches." This is an irrelevant quibble. If, as the trial court held, "offices" includes "branches," it does not matter that the word "branches" is not used in RCM 5-1124. And the only kind of branch which RCM 5-1124 could possibly authorize in the present case is a "new" branch. This is so because the office of the acquired Butte bank has never before been a branch and, as operated after the consolidation, must for the first time become a "new" branch of the consolidated bank.

Once again, appellants attempt statutory paraphrase (App. Br. 37) to lend credibility to their position, but the paraphrase is clearly in error because it uses the words "Anaconda Bank" where the title "First National Bank" should appear. A correct paraphrase would read:

> "(b) First National Bank (the 'resulting bank'), resulting from the consolidation of Daly National Bank of Anaconda, under whose charter the consolidation was effected, with The First National Bank of Butte may retain and operate as a branch the main office or a branch office of The First National Bank of Butte if, under subsection (c) of this section, such main office or branch office might be established as a new branch of First National Bank.
>
> (c) First National Bank may establish and oper-

> ate a new branch at Butte if such establishment and operation are now authorized to State banks by RCM 5-1124."

Because, as we have shown, RCM 5-1124 would authorize operation of a Butte branch by First National Bank if it were a state bank, it follows that the same authorization exists in the present case. Appellants' paraphrase misleads by creating the appearance that the operation of a branch in Butte is permissible only if the acquiring Anaconda bank could have opened a *de novo* branch in Butte. To the contrary, all that is necessary is that the "consolidated" bank, First National Bank, be able to operate offices at the locations of the "consolidating" banks, and intervenors have never contended otherwise.

3. Appellants contend that their interpretation of Section 36(b)(2) "makes good sense" and "follows the congressional intent" (App. Br. 37). Yet they also stress the congressional purpose, in enacting the National Bank Act, to place state and national banks on a basis of competitive equality where branch banking is concerned (App. Br. 13-14, 26, n. 25). They cannot have it both ways, because their reading of Section 36(b)(2) would establish a situation of inequality—favoring state banks as against national banks—contrary to the congressional policy.

If the trial court was correct, as intervenors believe, then RCM 5-1124 authorizes state banks to operate branches pursuant to a consolidation. Unless national banks have the same opportunity, they will be placed at a competitive disadvantage. It follows that appellants' artificial interpretation of Section 36(b)(2) must be erroneous The real question in this case is, what does RCM 5-1124 authorize?

Appellants' resort to Section 36(b)(2) is simply a smoke-screen designed to shroud the real issue in confusion. The National Bank Act, including Sections 36(b)(2) and 36 (c), was, by appellants' own admission, intended to place national banks and state banks on an equal footing. Therefore, Sections 36(b)(2) and 36(c) must be read here to authorize national banks to do whatever is authorized to state banks under RCM 5-1124. As we have shown, that statute authorizes branching pursuant to a consolidation.

4. There is no merit to appellants' contention (App. Br. 26, n. 25) that the District Court's decision has upset the balance of competitive equality in Montana.

If the Court affirms the decision below, the Montana Attorney General's Opinion (P. Ex. No. 1) will be without authoritative effect. Absent litigation, that opinion might have been entitled to some weight, but it "is not to be regarded as a legal precedent or authority of such character as a judicial decision." *Mogis v. Lyman-Richey Sand & Gravel Corp.*, 189 F. 2d 130, 139-140 (8th Cir. 1951), *cert. denied* 342 U. S. 877. Even in jurisdictions where an opinion of the attorney general is, by statute, binding upon administrative officials, it ceases to be so when overruled by a court of competent jurisdiction. See, *e.g.*, Minn. Stat. Ann. §8.07. And the rule that a public official is obliged to follow an opinion of the attorney general is inoperative when there is no longer a basis for well-founded doubt or uncertainty as to the construction to be placed upon a statute. *Standard Surety & Casualty Co. v. Oklahoma*, 145 F. 2d 605, 609 (10th Cir. 1944).

Thus, if this Court affirms the District Court's decision that the statute law of Montana affirmatively authorizes the establishment of a branch by a state bank following con-

solidation, the contrary opinion of the Montana Attorney General will have no further significance. In the unlikely event that appellant Leuthold should attempt to rely on that opinion as his reason for denying to consolidating state banks the privilege of conducting a banking business at more than one location, he will be in clear violation of his legal duty, and the consolidating state banks may force him to grant such authority by resort to the established Montana proceeding for a writ of mandate. (See RCM Sections 93-901 to 93-9114). In any event, the possibility of such rough treatment of Montana state banks by the Montana Superintendent of Banks seems remote to say the least. Moreover, it is irrelevant here. As the District Court stated, "If the administrator of the state law sees fit to deprive the state banks of rights which the statute law gives them, the resulting inequality is created by administrative fiat and not by statute law." (See Appendix B hereto.)

5. Appellants cite no judicial authority for their interpretation of Section 36(b)(2). Further, they note that the District Court appears not to have considered their argument under Section 36(b)(2) in reaching its decision (App. Br. 28).

This is not surprising, for appellants cannot fairly be said to have relied on this theory below. This "new branch" theory under Section 36(b)(2), mentioned only once as a tardy afterthought in a motion hearing, was never pursued. It did not appear as a basis for a cause of action in appellants' complaint, and it was never briefed or argued before the trial court. Nor was any of the factual information set forth in Part B of appellants' brief placed before the trial court.

We have already noted, in Part I.A. 2. of this brief, that

an appeal must be decided solely upon the evidence actually produced in the court below. See, *e.g.*, *Moose v. Vesey*, 225 Minn. 64, 67, 29 N. W. 2d 649 (1947), and authorities cited therein. It is equally clear that a party may not rely on a new theory, *Allen v. Central Motors, Inc.*, 204 Minn. 295, 283 N. W. 490 (1939), or a new statutory subsection, *American Surety Co. v. Greenwald*, 223 Minn. 37, 25 N. W. 2d 681 (1946), on appeal. The object of a trial is to get all issues and evidence before a forum of first impression. This purpose would be defeated by consideration of appellants' theory and evidence under Section 36(b)(2) by this Court.

II.

THE DISTRICT COURT CORRECTLY HELD THAT APPELLANTS FAILED TO STATE A CLAIM UNDER THE BANK HOLDING COMPANY ACT.

The Bank Holding Company Act of 1956 provides, in *12 U.S.C.* §1842(d), that no application for the purchase of a bank located in one state by a bank holding company having its principal office in another state shall be approved unless such an acquisition is specifically permitted by the law of the state in which the acquired bank is located. Appellants and *Amici* assert that this provision effectively prohibits the bank consolidation here in question.

However, *12 U.S.C.* §1842(a) provides:

> "(a) It shall be unlawful except with the prior approval of the Board * * * (4) for any bank holding company or subsidiary thereof, *other than a bank*, to acquire all or substantially all of the assets of a bank. * * *" (Emphasis added.)

Thus, by the express terms of the Bank Holding Company Act, acquisitions of the assets of a bank by a bank subsidiary of a holding company are not prohibited. The consolidation approved in this case by the Comptroller is within the above exception to the Act.

The Bank Holding Company Act has been construed by the Federal Reserve Board, which is charged with the duty of enforcing the Act, not to apply to such acquisitions. The Board's interpretation has recently been approved in *State of South Dakota v. National Bank of South Dakota,* 219 F. Supp. 842 (D.S.D. 1963), *aff'd* 335 F. 2d 444 (8th Cir. 1964), *cert. denied* 379 U. S. 970 (1965):

> "The phrase 'other than a bank' in subsection (3) creates an exception to the restrictions contained in the remainder of the statute. The exception applies when the assets of a bank are acquired by a bank which is a subsidiary of a holding company.
>
> "The Board of Governors of the Federal Reserve System recognized this fact and recommended a change in the statute which would have withdrawn the exception. Federal Reserve Bulletin, July 1958, pp. 787-89. The change was not adopted. In 1960 the recommendation was withdrawn by the Board with the explanation that since the Bank Merger Act of 1960, 12 U.S.C.A. §1828(c), required the prior approval of one of the Federal bank supervisory agencies in practically all cases of bank mergers and absorptions, the extension of the coverage of the Bank Holding Company Act to cover bank mergers in which holding company banks are involved would produce an unjustified duplication of supervision. 47th Annual Report of the Board of Governors of the Federal Reserve System, 1960, pp. 98-99, as quoted in a letter from the Hon. James J. Saxon, Comptroller of the Cur-

> rency, to the Hon. Wright Patman, Chairman, Committee on Banking and Currency, March 14. 1963. Hearings before the House Committee on Banking and Currency, 88th Cong., 1st Sess., pp. 153-155." 219 F. Supp. at 853.

Plaintiffs in *South Dakota, supra,* also asserted the argument raised by appellants in this action that *12 U.S.C.* §1842(d) prohibits the consolidation approved by the Comptroller. Both the District Court, and the Court of Appeals rejected the plaintiffs' contention. The District Court noted that the Federal Reserve Board has consistently construed §1842(d) to apply only to acquisitions which must be approved by the Board pursuant to §1842(a). The Court stated:

> "The State argues that the words 'Notwithstanding any other provision of this section, no application shall be approved * * *' in §1842(d) make that subsection applicable to the instant case. This is not true, however, since under §1842(a)(3), approval by the Board of Governors is not required when a subsidiary bank of a holding company acquires the assets of another bank. The Board of Governors, in a letter to Mr. Joseph H. Colman, Chairman of the Board of First Bank Stock Corporation, dated April 30, 1963, stated that it has consistently construed §1842(d) to apply only to cases in which Board approval is required under §1842(a). The interpretation of the Board of Governors, while not controlling, is entitled to substantial weight. First National Bank in Billings v. First Bank Stock Corporation, 9 Cir., 1962, 306 F. 2d 937, 941. The Court believes that the Board's interpretation of §1842(d) is correct. It follows, then, that the acquisition of the assets of the Thomson banks fell within the exception contained in §1842(a)(3) of the Bank Holding Company Act of 1956." 219 F. Supp. at 853.

See also, *First National Bank in Billings v. First Bank Stock Corp.,* 197 F. Supp. 417, 422 (D. Mont., 1961), *aff'd* 306 F. 2d 937 (9th Cir., 1962).

Plaintiffs in *South Dakota, supra,* argued, as do the appellants in this action, that the court should "pierce the corporate veil." They alleged that the acquisition was actually by the bank holding company and not by the subsidiary. This the Court refused to do:

> "* * * While it is true that courts have the power to pierce the corporate veil when the situation warrants such action, Ohio Tank Car Co. v. Keith Ry. Equipment Co., 7 Cir. 1945, 148 F. 2d 4, the Court does not believe that this is a proper case for the exercise of such power. There was no fraud or bad faith involved in this merger. It is true that the stockholders of the Thomson banks received First Bank Stock stock in exchange for the assets of the banks. There were good reasons why this was desirable from their standpoint, however. By receiving stock instead of cash, the stockholders had the benefit of a tax-free exchange. Moreover, they received shares of a stock that is traded in the over-the-counter market and whose day to day market value can thus be readily ascertained. The merger does not strike the Court as being a subterfuge, and the Court will not interfere with it merely because it may have enabled First Bank Stock to take advantage of a legitimate exception in the Bank Holding Company Act." 219 F. Supp. at 854.

On appeal the Court of Appeals for the Eighth Circuit held that the decision of the District Court was correct:

> "* * * We have chosen to review such decision upon the merits Judge Mickelson's opinion, 219 F. Supp. pp. 852-854, convincingly demonstrates that the activities here attacked constitute an acquisition of as-

sets (not of stock) by a bank (not by a holding company) and hence we agree that the transaction falls within the exception granted by §1842(a). Such section, so far as here material, provides:

> '(a) It shall be unlawful except with the prior approval of the Board * * *; (3) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank * * *.'

"The words in the statute 'other than a bank' clearly show the intention of Congress not to require a bank acquiring the assets of another bank to obtain Board approval. The remaining subsections of §1842, including subsection (d) largely relied upon by the plaintiff, set forth the procedures to be followed where an application to the Board of Governors is required. The words of subsection (d) reading: 'no application shall be approved under this section' manifest a Congressional intention that the section only applies to instances where approval of the Board of Governors is required. As Judge Mickelson points out, such interpretation is substantiated by the legislative history and the administrative interpretation of such provisions by the Board of Governors." 335 F. 2d at 448-449.

With respect to the argument that the acquisition by the subsidiary was in reality one by the holding company, the court also affirmed the decision of the District Court:

> "Plaintiff urges that the corporate veil should be pierced and that the transaction should be treated as an acquisition by the holding company rather than by the bank. The trial court properly rejected such contention, stating that no subterfuge was here involved. National Bank is a separate corporation. It

> has held a national charter for many years and is to continue as the surviving bank. It serves a definite corporate purpose, separate and distinct from the holding company. First Bank Stock Corporation has existed as a separate corporation owning stock of National and other banks for a considerable period of time. In this respect, this case differs materially from Whitney Nat'l Bank v. Bank of New Orleans and Trust Co., supra." 335 F. 2d at 449.

The facts in this case are virtually identical to those in the *South Dakota* case. The Daly bank, organized in 1883, has acquired the assets of the First. As a consequence, there is now a single resulting bank, First National Bank, operating offices at two locations. The holding company, Banco, organized in 1929, did not acquire the old First of Butte and turn it into a subsidiary. Rather, the acquiring entity was the Daly, and only one entity, First National Bank, survives the consolidation. That entity has *one* president and *one* board of directors. In no sense was the acquisition a sham, for the parties involved are old, established institutions and the transaction did not leave the First of Butte as a separate operating entity.

Thus, no subterfuge is involved in this case. The parties have merely proceeded under an express exception to the provisions of the Bank Holding Company Act. The approval of the Comptroller and the interpretation given the Act by the Federal Reserve Board are entitled to great weight in establishing that the Act does not prohibit this consolidation. The Bank Holding Company Act, like the National Bank Act, is federal law. See, *Millard v. National Bank of Detroit*, 338 Mich. 610, 615, 61 N. W. 2d 804 (1953); *State of South Dakota v. National Bank, supra*, 219 F. Supp. 842, 846. Since these statutes are adminis-

tered by the Comptroller and the Board, the interpretation of their requirements by those agencies is entitled to "great deference." See, *Udall v. Tallman,* 380 U. S. 1, 16 (1965); *First National Bank in Billings v. First Bank Stock Corp.,* 306 F. 2d 937, 941 (9th Cir., 1962). Such deference is especially appropriate now that those interpretations have the support of the Court of Appeals for the Ninth Circuit and the District Court for South Dakota in the *South Dakota* case (which rejected the arguments of the Independent Bankers Association, appearing by its counsel, Mr. Horace R. Hansen, as *amicus curiae*), of the District Court for Montana in *First National Bank in Billings v. First Bank Stock Corp., supra,* and of the trial court in this case. (See Appendix B to this brief.)

Moreover, it is important to note that the interpretation of the statute advanced by appellants and *Amici* would destroy the balance of competitive equality between banks which appellants strongly profess to support. If the Bank Holding Company Act is read to prohibit the asset acquisition here in question, then a bank owned by a bank holding company may not make an acquisition which is open to a bank not so owned. Even the appellants and the Attorney General of Montana admit that Montana law permits state banks to consolidate. The principle of competitive equality therefore requires that the Bank Holding Company Act be read to permit, rather than prohibit, the consolidation of national banks here in question.

As the foregoing authorities show, there is no impediment to this construction in either the statute or its legislative history. Only by striking the words "other than a bank" from Section 1842(a) can appellants' contrary interpretation be upheld. What appellants and *Amici* really seek is

amendment of the statute. The Congress has refused to perform such legislative surgery, and appellants and *Amici* cannot reasonably ask that this Court do so.

III.

THE DECISION BELOW IS SUPPORTED BY ADDITIONAL INDEPENDENT GROUNDS.

It is well settled that a party which is satisfied with the judgment below may argue for its affirmance on grounds which were overlooked, ignored, or even rejected by the lower court. See, *e.g., United States v. American Ry. Express Co.,* 265 U. S. 425, 435-436 (1924); *Langnes v. Green,* 282 U. S. 531, 538-539 (1931). There are numerous additional grounds for affirmance in the present case.

A. Appellant Leuthold Lacked Standing to Sue.

The trial court found that appellant Leuthold had standing to sue Intervenors contended that he did not, relying on a case virtually identical to the present case, *State of South Dakota v. National Bank of South Dakota,* 219 F. Supp. 842 (D.S.D. 1963), *aff'd* 335 F. 2d 444 (8th Cir. 1964), *cert. denied* 379 U. S. 970 (1965).

In *South Dakota,* as here, the plan of consolidation called for the acquiring bank to obtain all of the assets of the acquired banks in exchange for stock of the bank holding company (First Bank Stock Corporation) which owned a majority of the stock of the acquiring bank. The Comptroller approved, and the resulting bank established branches at the locations of the three acquired banks. The Attorney General of South Dakota then brought an action against the resulting bank and its parent holding company, claiming violations of the National Bank Act, the Bank

Holding Company Act, and South Dakota banking law. The complaint sought a declaratory judgment, injunctive relief against operation of the branches, and an order for divestiture of the acquired assets.

The District Court held that the state of South Dakota lacked standing to complain, and it stated (219 F. Supp. at 848):

> "It has been held that violations of the National Bank Act may be challenged only by the federal government. Kerfoot v. Farmers & Merchants' Bank, 218 U.S. 281, 31 S. Ct. 14, 54 L. Ed. 1042 (1910); National Bank of Genesee v. Whitney, 103 U. S. 99, 26 L. Ed. 443 (1880); Union National Bank v. Matthews, 98 U. S. 621, 25 L. Ed. 188 (1878).
>
> "The Comptroller of the Currency is charged under 12 U.S.C.A. §93 with the duty of prosecuting actions for violations of any of the provisions of the National Bank Act. There is no provision for enforcement of the national banking laws by the states. . . ."
>
> *   *   *   *   *
>
> "The enforcement of the Bank Holding Company Act of 1956 is dependent upon criminal prosecution. 12 U.S.C.A. §1847. There is no provision in the Act for civil enforcement, and although there apparently have been no decisions respecting the enforcement of the Act, the legislative history of the Act leads the Court to believe that Congress clearly intended to limit the enforcement to criminal prosecutions. . . . Where Congress has not provided for civil suits to enforce federal legislation, it is not for the courts to do so. . . .
>
> "For the reasons heretofore stated, the Court is of the opinion that the State of South Dakota has no standing to challenge the validity of the establish-

> ment and operation of the three branch banks by the defendant National Bank, and that likewise, the State has no standing to maintain an action to enforce the provisions of the Bank Holding Company Act of 1956."

Upon appeal, the question raised under the National Bank Act had become moot, and the Court of Appeals agreed with and affirmed the District Court's conclusions with respect to the Bank Holding Company Act (see 335 F. 2d, at 447-448).

Intervenors respectfully submit that the *South Dakota* case is squarely in point and convincingly demonstrates that appellant Leuthold lacked standing to bring the present action.

B. The Bank Holding Company Act Does Not Confer Civil Jurisdiction.

The District Court also rejected intervenors' argument that it lacked jurisdiction to enforce the Bank Holding Company Act. Here again, the *South Dakota* case supports intervenors.

In the foregoing passage from the District Court opinion, the court explicitly noted that the act may be enforced only by means of federal criminal prosecution. The court therefore concluded that "where Congress has not provided for civil suits to enforce federal legislation, it is not for the courts to do so."

On appeal, the Court of Appeals agreed, stating (335 F. 2d, at 447-448):

> "The Bank Holding Company Act contains no express provision for civil enforcement. The legislative history of the Act as shown by Judge Mickelson's opin-

ion supports the defendants' view that Congress intended the criminal enforcement provision to be exclusive. . . . In an earlier proposed Bank Holding Company Bill, S. 310, 77th Congress, express provision is made for civil enforcement of any liability or duty and for injunctive relief.

"At various hearings before Congressional committees, Governors of the Federal Reserve System charged with the administration of the Act advocated criminal penalties as the exclusive means for enforcement. Governor Robertson, appearing before the Committee on behalf of the Board on June 24, 1952, stated:

> 'Bearing always in mind the desirability of keeping the legislation to a minimum, it is our feeling that the only essential measure of enforcement, and the most effective one, would be a provision for criminal penalties for violation of the statute or of conditions prescribed by the administering agency in granting consent to acquisitions of bank stocks. This would place complete responsibility for enforcement of the law in the Department of Justice. The administering agency would not be placed in a position in which it would be required to institute proceedings for enforcement.' . . .

"Similar statements were made at subsequent hearings in subsequent years. . . .

"Thus it appears that the Act and its legislative history disclose no intent on the part of Congress to create rights to be enforced by civil litigation."

It is therefore apparent that the present claim of violation of the Bank Holding Company Act should have been dismissed for want of jurisdiction.

C. An Injunction Is Inappropriate because Irreparable Injury Was Not Shown.

Intervenors argued in the District Court that appellants were not entitled to injunctive relief except upon a persuasive showing of irreparable injury. "In addition to having a clear right, there must also be an apparent and pressing necessity for an injunction. The injury threatened must be imminent and such as can only be avoided by an injunction." *Emery v. Emery,* 122 Mont. 201, 200 P. 2d 251, 261 (1948). The burden of showing irreparable injury is particularly heavy where, as here, appellants seek to enjoin a public official in the discharge of his duty. See *State v. Kreig,* 145 Mont. 521, 402 P. 2d 405 (1965).

In a banking context, as elsewhere, the plaintiff must make a strong showing of irreparable injury in order to prevail. Thus, in *Bank of Sussex County v. Saxon,* 253 F. Supp. 857 (D.N J. 1966), plaintiff sought a preliminary injunction on the basis of an affidavit stating it had lost over 30 accounts, totaling approximately $200,000, by reason of unlawful establishment of a branch by a competitor, and that continued operation of the branch would divert more than 600 of its checking accounts, having deposits of $600,000, and 1,200 savings accounts, having deposits of $1,200,000 in addition to depriving plaintiff of substantial amounts of personal and mortgage loans. All of these allegations were denied by the competing bank. The court concluded that the affidavits did *not* disclose probable irreparable damage to plaintiff bank (see 253 F. Supp., at 860).

Also in a banking context, it has been emphasized that the remedy of injunction is extraordinary and that "the granting of such relief is not, as a rule, a matter of

absolute right, but on^ of legal discretion." *First National Bank in Billings v. First Bank Stock Corp.*, 197 F. Supp. 417, 427 (D. Mont. 1961), *affirmed* 306 F 2d 937 (9th Cir., 1962). The court there noted, "It is not sufficient grounds for the issuance of an injunction that injurious acts may possibly be committed. There must be at least a reasonable probability that the injury will be done if no injunction is granted and there must be more than mere fear or apprehension . . ." (197 F. Supp., at 428).

Intervenors believe that all of appellants' evidence on damage was speculative, conjectural, and without foundation, and that it failed to make the showing of irreparable injury which the law requires. In this connection, the Court's attention is directed to the trial transcript.

Appellants' principal witnesses on injury were Harold Pitts, President of appellant Miners Bank of Montana, Paul Robert, President of appellant Security Bank, and Charles Rubie, President of Bancorporation of Montana, which owns seven Montana banks, including appellant Miners Bank Each of these men was permitted to testify on a wide range of business and economic matters despite intervenors' objections to this opinion evidence as elicited from persons obviously not qualified as experts.

On direct examination, witness Pitts testified that the proposed consolidation would result in a loss to the Miners Bank of $10,505 in one year as a result of predicted new loan competition from the consolidated bank (Tr. 39-43). However, on cross examination, he admitted that: (a) this computation assumed that the Butte loan market was static, whereas it might be expanding (Tr. 54-55); (b) the entry of the Security Bank into the Butte market for the first time in 1954 had not prevented the Miners Bank from

greatly increasing its deposits and loans (Tr. 55 57); (c) the new Security Bank did not injure the Miners Bank (Tr. 58); (d) he, as a loan officer, would require considerable time to inject a large amount of new money into the Butte loan market (Tr. 62-65); (e) he could sell loan participations to the consolidated bank without injuring the Miners Bank (Tr. 68); (f) some Butte loans are made by banks in other cities and the consolidated bank could handle these without injuring the Miners Bank (Tr. 68-69); (g) and even that, by conservative computation, the Miners Bank could probably reinvest moneys remaining after any lost loans to derive an income of at least $9,575 to counterbalance the claimed loss of $10,505 (Tr. 69-75).

Witness Robert estimated the loss of the Security Bank at $10,330, also because of a predicted loss of loans to the consolidated bank. However, on cross examination, he admitted that: (a) he, too, would probably require some time to inject a large amount of new loan money into the Butte market (Tr. 109-110); (b) his computation of loss was based on an averaging process that failed to take account of variations in the type of loan that might be involved (Tr. 111, 112); (c) the cost of reinvesting in municipal bonds would be at least somewhat lower than the cost of making local loans (Tr. 112-114); (d) his bank could not currently absorb additional loan demand in Butte (Tr. 114); (e) loan volume in Butte has expanded in recent years (Tr. 115-116); (f) his bank, too, could sell loan participations to the consolidated bank without loss (Tr. 117); (g) his bank's location gave it a measure of competitive advantage (Tr. 118); and (h) his opening of a *de novo* bank in Butte in 1954-55 did not damage banking in that city (Tr. 119-120).

On direct examination, witness Rubie testified that the proposed consolidation would cost the Miners Bank $13,-181.44 (Tr. 137-138), even though Mr. Pitts, the President of the Miners Bank, had already estimated its probable loss at $10,505, as Mr. Rubie knew (Tr. 145). On cross examination, Mr. Rubie attempted to establish, for separate purposes, that the Butte loan market both was, and was not, fluid (Tr. 145-148). He then: (a) demonstrated an obvious inability to predict the future rates of the consolidated bank (Tr. 148-152); (b) admitted that part of the Butte loan demand was being satisfied by outside money (Tr. 153-154); and (c) expanded on his earlier profit-and-loss testimony in a manner that cast grave doubt on its validity (Tr. 154-157, 159-160).

Thus, appellants' case on competitive injury was without foundation, lacked any degree of certainty, rested on invalid premises, and was riddled with internal inconsistencies.

In contrast, intervenors called Charles E. Haywood, Dean of the College of Business and Economics at the University of Kentucky and a man eminently qualified to testify on banking and economic trends (see Tr. 173-179). Appellants chose not to cross examine Dr. Haywood (Tr. 211). His unchallenged testimony was to the effect that: (a) the prospects for national economic growth are good (Tr. 181); (b) it is likely that the Butte-Anaconda area will participate in this rising trend (Tr. 182) and the banking industry of the area can anticipate more vigorous expansion (Tr. 183-184); (c) for a number of persuasive reasons, the consolidated bank is not likely to damage or injure the competitive structure of the banking business in Butte (Tr. 189-191, 193-203); (d) in fact, the consolidated bank may

have some difficulty retaining old business (Tr. 192-193), and may also help to further economic growth in Butte to the benefit of the entire community (Tr. 203-204, 207); (e) and, finally, absent consolidation, the Butte bank faces a decline by "cannibalization" which could lead to its elimination from the Butte banking market (Tr. 204-205).

On the basis of all of the foregoing, intervenors submit that appellants have totally failed to establish the probability of irreparable injury necessary to support a claim for injunctive relief.

D. An Injunction Would be Contrary to the Public Interest.

There is a strong public interest in the maintenance of competition, and that interest clearly extends to competition among banks. See, *e.g.*, *United States v. First City National Bank of Houston*, 18 L. Ed. 2d 181 (U.S., March 27, 1967).

The Supreme Court has said that "Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved." *United States v. First National City Bank*, 379 U. S. 378, 383 (1965); *Virginian Ry. Co. v. System Federation No. 40*, 300 U. S. 515, 552 (1937). Indeed, it has gone so far as to say that a court of equity "may in the public interest, even withhold relief altogether, and it would seem that it is bound to stay its hand in the public interest when it reasonably appears that private right will not suffer." *Securities and Exchange Commission v. United States Realty and Improvement Co.*, 310 U. S. 434, 455 (1940).

To illustrate, in *United States v. Morgan,* 307 U. S. 183, 194 (1939), the Court said:

> "It is familiar doctrine that the extent to which a court of equity may grant or withhold its aid, and the manner of moulding its remedies, may be affected by the public interest involved. . . . Congress having by the Packers and Stockyards Act established the public policy of maintaining reasonable rates for stockyard services, and having prohibited and declared unlawful any unjust or unreasonable rate, a court of equity should be astute to avoid the use of its process to effectuate the collection of unlawful rates. . . ."

Here, as the uncontradicted testimony of witness Haywood shows (Tr. 202-203, 207), the proposed consolidation would beneficially serve the needs and interests of the banking public of Butte Conversely, denial of the right to consolidate may destroy intervenor Butte bank as a significant competitive entity (Tr. 204-205). Indeed, witnesses Pitts (Tr. 77-79) and Rubie (Tr. 157-159) both testified to participating in negotiations aimed at acquiring the First of Butte for Bancorporation of Montana and *closing* it thereafter. It is entirely possible that this will be the fate of the First of Butte if the present consolidation is denied. It is a fate that would leave three competitors in the Butte banking community instead of four, to the detriment of the public of Butte.

The facts and law therefore demand that the public interest be served by affirmance of the decision below.

E. An Injunction Would be of Doubtful Effect.

It is axiomatic that a court of equity will deny injunctive relief in a situation in which an injunction is unlikely to accomplish its purpose. A clear case in point is the de-

cision in *Great Northern R. Co. v. Lumber and Sawmill Workers, Local Union No. 2409,* 140 F. Supp. 393 (D. Mont. 1955), *affirmed* 232 F. 2d 628 (9th Cir., 1956), *cert. denied* 352 U. S. 837, which involved picketing against a common carrier in a labor dispute. The District Court deemed it unnecessary to determine whether the Norris Laguardia Act applied because *even if the picketing was illegal,* an injunction would not provide an effective remedy. Quoting from *Great Northern R. Co. v. Local Great Falls Lodge of International Ass'n of Machinists, No. 287,* 283 Fed. 557, 563 (D. Mont. 1922), the Court first set forth the rules governing injunctive relief, as follows:

> "Injunctions go only in cases of urgent necessity, made to appear by competent, material, credible, and preponderating evidence, to guard against injuries, not merely feared by the applicant, but reasonably to be apprehended, and likely to be irreparable. They are extraordinary remedies, granted with great caution, and in the exercise of sound judicial discretion. *That the applicant is annoyed, threatened, and injured will never justify a court to grant him an injunction, unless these trespasses are so great that they threaten him with irreparable injury, within the settled meaning of that term in equity*" (140 F. Supp., at 395; emphasis in the original).

The court then stated:

> "*Also, before a Court will grant an injunction, it should appear with reasonable certainty that the injunction will be effective to prevent the damage which it seeks to prevent. From the allegations of the complaint here, it is extremely doubtful that an injunction would alleviate plaintiff's difficulty at all . . .*" (140 F. Supp. at 396; emphasis added).

This Court affirmed on the basis of the opinion of the District Court (232 F 2d 628, 629).

Great Northern highlights a major difficulty with appellants' complaint in the present case. Their alleged grievance arises not out of the proposed consolidation, but out of the prospect of effective competitive operation of the consolidated bank. But the proposed consolidation is not necessary to the rise of effective new competition from the First National Bank of Butte. Unless the appellant banks are, in fact, able to "cannibalize" the First of Butte, such competition can come from the sale of that bank to another, or even from the advent of new management without a sale. Since the bank is up for sale, and since its present management is nearing retirement, some such change is virtually certain. It follows, therefore, that an injunction against the proposed consolidation may well be ineffective to save appellants from the increased competition which they fear.

Hence, as in the *Great Northern* case, regardless of the other legal questions raised, the District Court's denial of an injunction was correct.

CONCLUSION

For all of the foregoing reasons, the judgment of the District Court should be affirmed.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

John D. French

JOHN D. FRENCH,
An Attorney for Intervenor-Appellees.

CERTIFICATE OF SERVICE

I hereby certify that the brief of intervenor-appellees has been served by mailing three copies thereof to each of the following counsel of record in this cause: Donald A. Garrity, assistant attorney general, Mitchell Building, Helena, Montana 59601, John M. Schiltz, 403 Electric Building, Billings, Montana 59101, and Fred J. Weber, Citizens Bank Building, Havre, Montana 59501, attorneys for appellants; Moody L. Brickett, United States Attorney, United States Post Office & Court House, 400 N. Main Street, Butte, Montana 59701, and Stephen R. Felson, Appellate Section, Civil Division, United States Department of Justice, Washington, D.C. 20530, attorneys for appellee; and Horace R. Hansen, 600 Degree of Honor Building, St. Paul, Minnesota, attorney for *Amici Curiae*.

Dated February 20, 1968.

John D. French

JOHN D. FRENCH,
An Attorney for Intervenor-Appellees.

APPENDIX A

In The United States District Court
For The District of Montana
Butte Division

Civil No. 1444

ALBERT E. LEUTHOLD, Superintendent of Banks, State of Montana, Helena, Montana, SECURITY BANK and MINERS BANK OF MONTANA, N. A.,
Plaintiffs,

vs.

WILLIAM B. CAMP, Comptroller of the Currency,
Defendant,

THE FIRST NATIONAL BANK OF BUTTE and DALY NATIONAL BANK OF ANACONDA,
Intervenors.

FINDINGS OF FACT

From the evidence introduced, the Court finds:

I.

The First National Bank of Butte has not been in real competition with the other banks in Butte for some time. In 1940 it had 46.7% of all of the deposits in Butte banks as compared to 23.5% in 1965. Its deposits shrank 1.8 million between June 30, 1966 and June 30, 1967. At the

end of 1965 the ratio of loans to deposits was 23.6% as compared to an average of about 60% for its competitors. The ratio of local loans to deposits was 4.4%. In the real estate field in 1965, as judged by the mortgage recordings, it made five loans for a total of $97,500.00 out of a total of 468 loans for a total of $6,738,323.98 by all Butte banks. It has no installment loan department and makes almost no consumer loans.

II.

Under different lending policies there would be available for lending in the Butte market about $6,000,000.00 which is not now loaned or is loaned out of the Butte area.

III.

If the consolidation is effected, there will be a new and vigorous management of the First National Bank of Butte which will compete for local loans of all kinds and deposits with all of the Butte banks, including Miners.

Opinions were voiced by qualified experts that damages in excess of $10,000.00 per year would be sustained by Miners if the consolidation takes place. The court is of the opinion that these estimates omitted some factors which would have to be considered and fixed the yearly damages too high.

V.

The court finds that there are two variables here, the amount of yearly damage and the time over which it is to be projected. It is not realistic to project the non-competitive character of the First National Bank of Butte indefinitely into the future, but in view of the amounts of money in-

volved, the fact that many logical purchasers are prohibited by law from buying, and the fact that the present owners have for many years allowed the present situation to continue, the court is of the opinion, and finds, that as the variables mentioned are judged together the damages would exceed $10,000.00.

VI.

The court finds that the value of the matter in controversy with the Miners Bank of Montana N.A. is in excess of $10,000.00.

VII.

The court makes no finding as to damages which would be sustained by Security Bank if the consolidation is effected.

Dated this 28th day of August, 1967.

RUSSELL E. SMITH,
United States District Judge.

APPENDIX B

(Title of Cause.)

OPINION AND ORDER

This case concerns branch banking in Montana. The Bank Holding Company Act, 12 U.S.C.A. 1841 et seq. and the National Bank Act, 12 U.S.C.A. 36(c) are involved.

The plaintiffs are: Albert Leuthold, superintendent of banks of the state of Montana (superintendent), who has general supervisory power over state banks, and who is charged with the duty of executing all laws in relation to banks,[1] and who may close any bank which has violated any law of the state;[2] Security Bank (security), a bank chartered under the state law with offices in Butte; the Miners Bank of Montana, N.A. (Miners), a bank chartered under the federal law with offices in Butte.

The defendant is William B. Camp, acting comptroller of the currency of the United States (the comptroller).

The intervenors are The First National Bank of Butte (First of Butte) and Daly National Bank of Anaconda (Daly). Both are federal banks. Daly is a subsidiary of, and is controlled by, Northwest Bancorporation, a bank holding company. Daly proposes to acquire the assets of the First of Butte in exchange for stock of Northwest Bancorporation; to consolidate the First of Butte and Daly, and then to maintain full banking facilities in the present offices of the First of Butte and Daly. The comptroller has approved the plan and will issue a final certificate of approval unless enjoined by this court. At the outset the court

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[1]R. C. M. 1947, § 5-602, as amended.
[2]R. C. M. 1947, § 5-1101.

is faced with motions upon which rulings have been reserved and with affirmative defenses questioning the standing of the plaintiffs to sue and the court's jurisdiction.

JURISDICTION AND STANDING TO SUE.

This court does have jurisdiction and all parties have standing to sue. The decisions of the comptroller relating to branch banking are subject to review under the provisions of the Administrative Procedures Act.[3] The problem is fully discussed in First National Bank of Smithfield, N. C. v. First National Bank of Eastern North Carolina and James K. Saxon, Comptroller of the Currency, 232 F. Supp. 725 (E.D.N.C. 1964), affirmed on this point, 352 F. 2d 267 (4 Cir. 1965); Community National Bank of Pontiac v. Saxon, 310 F. 2d 224 (6 Cir. 1962); Bank of Dearborn v. Saxon, 244 F. Supp. 394 (E.D. Mich. 1965); American Bank and Trust v. Saxon, 248 F. Supp. 324 (W.D. Mich. 1965); Continental Bank v. National City Bank, 245 F. Supp. 684 (N.D. Ohio 1965), rev'd on other grounds, 373 F. 2d 283 (1967); Bank of Sussex County v. Saxon, 251 F. Supp. 132 (D. N.J. 1966). While the cases do not specifically say so, it is clear from the alignment of the parties that the courts treated competing banks as "persons suffering legal wrong . . . or adversely affected or aggrieved" within the meaning of 5 U.S.C. § 1009(a), and therefore entitled to a judicial review of agency action.

Whitney National Bank v. Bank of New Orleans, 379 U. S. 411 (1965) is not contrary. For the reasons later set forth the Bank Holding Company Act is not applicable here. In Whitney National Bank the issues which arose out of the Bank Holding Company Act were cognizable

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[3] 5 U. S. C. § 1001, et seq.

solely by the Federal Reserve Board and its findings were binding upon the comptroller. The Bank Holding Act provides that the decisions of the Federal Reserve Board are reviewable in the Circuit Courts.[4] The court in Whitney simply held that method of review to be exclusive.

The superintendent's standing to sue is not so clear. On this issue defendants and intervenors rely upon State of South Dakota v. National Bank of South Dakota, 219 F. Supp 842 (D. S.D. 1963), affirmed 335 F. 2d 444 (8 Cir. 1964), cert. den. 379 U.S. 970 (1965).[5] Plaintiffs rely upon Jackson v. First National Bank of Valdosta, 349 F. 2d 71 (5 Cir. 1965). Neither of these cases consider the applicability of the Administrative Procedures Act. In the South Dakota case substantial reliance was placed upon the proposition that where a regulatory act provides criminal penalties and is silent as to civil enforcement, that the criminal remedy will be deemed exclusive.[6] It is not desirable to use the criminal courts for a determination of economic rights. The penalties for incorrectly interpreting a law are too great and the criminal courts, because of the jury's inalienable right of pardon and the fact that the prosecutor cannot appeal from judgments of acquittal, are poor forums for the resolution of legal problems. The Administrative Procedure Act embracing as it does the declaratory judgment concept and providing rights of review which are not dependent upon a specific congressional authority to be found in the basic regulatory law, expresses a philosophy at odds with that underlying the rules relied upon

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[4] 12 U. S. C. § 1848.

[5] It may be noted that the Circuit Court did not pass upon the Superintendent's standing to sue for violation of the National Banking Act.

[6] The eighth circuit seems to answer the question of standing in terms of the existence of a remedy.

in the South Dakota case. Even if the right of review in this case could not be found in the language of the Administrative Procedures Act, the court would consider it in appraising the South Dakota result.

The Jackson case is followed here insofar as the "standing to sue" problem is treated as one concerned with the interest of the superintendent in the subject matter of the litigation, and the sufficiency of that interest to qualify him as a party plaintiff.[7] This court considers jurisdiction to be a different problem. Many have standing to sue who may not find their way into the federal district courts,[8] and the court here does not hold the Congress, in § 36 (c) of the National Bank Act, adopted the remedial provisions of state law, and thus obliquely conferred jurisdiction on this court. In other words, the holding here is that the superintendent is a person "suffering a legal wrong or adversely affected or aggrieved" within § 1009(a) of the Administrative Procedures Act.

In separate findings the court has concluded that as to Miners the value of the matter in controversy is in excess of $10,000.00. The solution of the controversy depends upon the application of the National Bank Act and the Bank Holding Company Act. A federal question is in-

[7]"Moreover, the Superintendent, as the primary enforcement officer of state banking laws which, under § 36(c), govern national banking associations, is particularly qualified to act as a plaintiff in cases such as this. He is also particularly well situated to represent interests adverse to those of a national bank which, even with the approval of the Comptroller of the Currency, would naturally be inclined to push the restrictions of § 36(c) to, or, if possible, beyond, their proper limits." Jackson v. National Bank of Valdosta, supra, at 75.

[8]The case of First National v. Union Trust Company, 244 U.S. 416, (1917) cited in Jackson did not involve the problem of jurisdiction of the federal district court.

volved and at least as to Miners the court does have jurisdiction under § 28 U.S.C. 1331(a).[9]

THE NATIONAL BANK ACT.

The Butte and Anaconda offices of the consolidated bank may be retained and operated unless such operation offends § 36(c) of the National Bank Act which provides in part:

> "A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: * * * (2) at any point within the State in which said association is situated, *if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition,* and subject to the restrictions as to location imposed by the law of the State on State banks." (Italics supplied.)

The problem in this case arises under the italicized portion of the section.

In 1927 the Montana Legislature adopted what now appears as § 5-1028 R.C.M. 1947. It provides:

> "No bank shall maintain any branch bank, receive deposits or pay checks, except over the counter of and in its own banking house. Provided, that nothing in this section shall prohibit ordinary clearing house transactions between banks * * *"[10]

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[9]Suburban Trust Company v. National Bank of Westerfield, 211 F. Supp. 694 (D. N. J. 1962); Bank of Sussex County v. Saxon, supra.

[10]This section was amended in 1963 to permit detached drive-in and

In 1931 the Montana Legislature adopted what now appears as § 5-1124 R.C.M. 1947. It provides:

> "When any two or more banks located in the same county or in adjoining counties shall consolidate in accordance with the provisions of section 5-1021, the consolidated bank may, if it has a paid up capital of seventy-five thousand dollars ($75,000.00) or more, upon the written consent of the superintendent of banks and under rules and regulations promulgated by him, *maintain* and operate offices in the locations of the consolidating banks." (Italics supplied.)

The Daly and First of Butte are located in adjoining counties. They have a paid up capital in excess of Seventy-five Thousand Dollars ($75,000.00). The consolidation will not be under § 5-1021 R.C.M. 1947, the state law providing for consolidation, but under federal authority. None of the parties contend that this poses any problem.

The superintendent has not given his consent and has promulgated no rules governing the operation of consolidated banks. Under § 5-1124, and under these facts, may the consolidated bank maintain two separate banking facilities?

It is not seriously urged that the lack of consent by the superintendent is fatal to the proposed operation. It seems clear that it is not.[11]

The real controversy on the National Bank Act aspect of this case revolves about the plaintiffs' argument that

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walk-up facilities under some circumstances. R. C. M. 1947, § 5-1028 (Supp. 1967).

[11]First National Bank of Smithfield, North Carolina v. Saxon, supra; American Bank and Trust Company v. Saxon, supra.

§ 5-1028 forbids branch banking in Montana, and that § 5-1124 provides no exception even in those cases falling within its provisions. The plaintiffs argue that the word "branch" has a very special meaning; that the word "office" is a word with broad connotations; and that the use of the word "office" in § 5-1124 cannot be held to embrace the word "branch" as used in § 5-1028. It is further argued that had the legislature intended to amend § 5-1028, it would have done so by amending that section, rather than enacting § 5-1124, which makes no reference to the branch banking statute. The plaintiffs bolster their arguments by statements of the superintendent of banks who has administratively interpreted the act, and by the opinion issued by the attorney general of the state of Montana.[12] It is the opinion of the court that § 5-1124 created an exception to § 5-1028, and does in the limited classes of cases therein described permit branch banking in Montana.

The main problem is to find the intention of the legislature. The first place to look for that intention is in the words used. What did a Montana legislator reading the word "office" in the bill which became § 5-1124 contemplate? Did he envisage a space in which tellers stood behind counters, received deposits and cashed checks, and officers sat at their desks, frowned and made loans? It is probable that he did, because in Montana, at least, there is no other image of a bank office. If he did, then he envisaged branch banking, because basically the business of

[12]There is no need to eleborate on the proposition that the National Bank Act sought to achieve an equality between state and national banks in branching matters: (First National Bank v. Walker Bank, 385 U. S. 252, 1966) and that what is forbidden to state banks by statute is also forbidden to national banks.

banking is receiving deposits and making loans. The word "office" is not foreign to banks and is commonly used to describe the place where banking activities take place. Congress has used the word in that sense.[13] The Federal Reserve Board uses the word in that sense.[14] The courts use the word in that sense,[15] and even the plaintiffs in their complaint use the word "office" to describe the place where the banking activities of the party banks take place. The Montana legislature, in the sections of the Commercial Code dealing with banking, uses the words "office" and "branch" as equivalents.[16] In the absence of a compelling reason for believing that the word "office" was used in some limited sense, it must be given its ordinary meaning, and in its ordinary meaning the word "office" describes a place where banking business is done.

This conclusion is fortified by the fact that unless the word "office", as used in § 5-1124 is given its normal meaning, the section does nothing. The superintendent suggested in a memorandum to the Montana legislature that § 5-1124 was enacted to "permit banks that were forced into liquidation to consolidate with another bank and to maintain an office for two or three months to wind up their banking business."[17] Apart from the fact that the language of the section indicates no such purpose and that there is no legislative history indicating it, the terms of the

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[13]12 U. S. C. 36(b)(2).

[14]Statement of Governor Robertson on behalf of the Federal Reserve Board before the House Committee on Banking & Currency, 82d Cong., 2d Sess., (June 24, 1952) pp. 16-18.

[15]First Hardin National Bank v. Fort Knox National Bank, 361 F. 2d 276 (6 Cir. 1966), cert. den. 385 U. S. 959 (1966).

[16]R. C. M. 1947, §§ 87A-4-102 and 87A-4-106.

[17]This same thought is expressed in an opinion of the Attorney General of Montana and in the briefs of the plaintiffs.

act seem to forbid any such interpretation. The use of the word "maintain" suggests continuity and casts doubt upon the suggestion of an operation limited to a period of two or three months. Why, if it were simply a matter of permitting activities necessary to close a consolidated bank, did the legislature confine the operation of this section to banks in adjoining counties, when, under § 5-1020, banks may be consolidated without regard to the county in which they are located? Why did the legislature require minimum capitalization if the office were to be operated for some limited purpose or time? Why would the consent of the superintendent, who has general supervisory power, be required for the maintenance of a temporary office for such limited purposes? Aside from all else, however, the question to which no one has given a satisfactory answer remains: Why, if § 5-1124 was intended to permit some activity short of banking, was it enacted at all? There is not now, and was not in 1931, any law which forbade banks from maintaining offices wherever they chose so long as they did not conduct a banking business in them.

Because § 5-1124 means nothing if the word "office" is given something less than its normal meaning, and because no reason has been suggested which indicates to the court that the legislature did intend a limited meaning, the court holds that § 5-1124 creates an exception to § 5-1028, and that what is sought to be done by the consolidating banks does not offend the statutory law of Montana. A consideration of the position of the superintendent and the opinion of the attorney general of Montana and the other canons of construction urged by plaintiffs does not lead to a contrary conclusion.

When the Montana legislature in § 5-1124 used the

word "office" without limitation, it specifically granted the authority to engage in banking in two locations under the limitations imposed by the section. The mere fact that the parties and counsel argue to the contrary does not mean that the power to maintain two offices arises by implication or recognition.

It is argued that the attorney general has ruled that state banks may not branch under the conditions described in § 5-1124; that the superintendent is bound by such ruling; and that henceforth state banks in Montana will be deprived of the equality of treatment which the National Bank Act sought to achieve. The answer to this is that Congress, in Section 36(c) of the National Banking Act, refers to the "statute law of the state". If the administrator of the state law sees fit to deprive the state banks of rights which the statute law gives them, the resulting inequality is created by administrative fiat and not by statute law.

THE BANK HOLDING COMPANY ACT.

Section 1842(a) of the Bank Holding Company Act[18] provides in part:

> "It shall be unlawful except with the prior approval of the Board, * * * (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; . . ."

Section 1842(d) provides:

> "Notwithstanding any other provision of this section, no application shall be approved under this sec-

[18]12 U. S. C. §§ 1841 et seq.

> tion which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted on July 1, 1966, or the date on which such company became a bank holding company, whichever is later, unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication. For the purposes of this section, the State in which the operations of a bank holding company's subsidiaries are principally conducted is that State in which total deposits of all such banking subsidiaries are largest As amended July 1, 1966, Pub. L. 89-485, § 7, 80 Stat. 237."

There is no Montana law authorizing an out-of-State bank holding company to acquire the assets of banks located in Montana.

Do the words "other than a bank" appearing in § 1842 (a) make the Bank Holding Company Act inapplicable to this case, or do the words in § 1842(d) "notwithstanding any other provision of this section, no application shall be approved" effectively negate the exception provided in § 1842(a)?

It is clear from the language of 1842(a) that a bank, even if a subsidiary of a holding company, may, without prior Federal Reserve Board approval, acquire the assets of another bank. § 1842(d) does no more than limit the

approval power of the Federal Reserve Board. It would seem, therefore, and the court so decides, that § 1842(d) does not apply to asset acquisitions which do not require prior Reserve Board approval. This is the result reached by the District and the Circuit Courts in State of South Dakota v. National Bank of South Dakota, supra.[19]

The court is asked to pierce the corporate veil and hold that since Northwest Bancorporation, by virtue of its ownership of Daly, will own the First of Butte, the Bank Holding Company Act is violated.

There is no suggestion of fraud or deception. Rather the plaintiffs argue that because what is done in terms of real ownership is so like what is prohibited, that what is done likewise should be prohibited. Were the Act which applies here one passed in recognition of some community moral judgment, then a court might be tempted to, and might well look behind the corporate forms, to protect the basic social mores involved. Here, however, we deal with a regulatory measure designed to control the expansion of bank holding companies. There is no declaration that expansion is per se bad—only that each expansion must be evaluated in terms of its effect on the general public interest. The act itself makes formal and perhaps arbitrary distinctions between asset and stock acquisitions, between bank and bank holding company acquisitions. Under these conditions it is the court's opinion that it should not, by disregarding the corporate forms, abolish the distinctions that Congress created. This result was reached in State of South Dakota v. South Dakota National Bank, supra.

This opinion together with the separate findings of fact

[19]If what is said on this problem in those decisions is dictum, then this court is not forced, but only persuaded, and the result is the same.

this day filed constitute the court's findings of fact and conclusions of law.

It Is Ordered, that all pending motions be, and the same are, hereby denied. On the merits It Is Ordered that plaintiffs be denied all relief.

Done and dated this 28th day of August, 1967.

RUSSELL E. SMITH,
United States District Judge.

No. 22,202

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ALBERT E. LEUTHOLD, Superintendent of Banks, State of Montana, Helena, Montana, SECURITY BANK and MINERS BANK OF MONTANA, N. A.,

Appellants,

v.

WILLIAM B. CAMP, Comptroller of the Currency,

Appellee,

and

THE FIRST NATIONAL BANK OF BUTTE and DALY NATIONAL BANK OF ANACONDA,

Intervenors-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA

BRIEF FOR THE APPELLEE

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I N D E X

CITATIONS

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No. 22,202

ALBERT E. LEUTHOLD, Superintendent of Banks, State of Montana, Helena, Montana, SECURITY BANK and MINERS BANK OF MONTANA, N. A.,

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v.

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
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BRIEF FOR THE APPELLEE

JURISDICTIONAL STATEMENT

This is an action for declaratory and injunctive relief by the Superintendent of Banks of the State of Montana and two Montana banks, attacking the approval by the Comptroller of the Currency of the consolidation of two national banks (I.R. 2-8 1/).

1/ "I.R." refers to volume I of the Transcript of Record. Volumes II and III contain the trial transcript.

The jurisdiction of the district court was invoked under 5 U.S.C. 1009 and 28 U.S.C. 1331, 1337, 1346, 1348 and 2201 (I.R. 2). A opinion and order denying plaintiff all relief was filed on August 29, 1967 (I.R. 54), and a notice of appeal was filed on behalf of all plaintiffs on the same day (I.R. 66). A final ju ment "nunc pro tunc" was entered on November 8, 1967, which pur ported to be "as of August 29, 1967." 2/ The jurisdiction of t Court is invoked under 28 U.S.C. 1291.

COUNTERSTATEMENT OF THE CASE

This action arises out of an application to the Comptroll of the Currency, dated October 1, 1966 (Pl. Exh. 10 3/), to con solidate two national banks. The First National Bank of Butte, Montana (hereafter "First National") was organized in 1877 and came a national bank in 1881. The Daly National Bank of Anacon Montana (hereafter "Daly") was organized in 1883 and became a national bank in 1965 (Def. Exh. G); Daly is a subsidiary of Northwest Bancorporation, a Minnesota bank holding company (Def Exh. F). The application requested permission for Daly to acquire the assets of First National in order to form a single consolidated bank under Daly's charter, with the title of "Firs National Bank" (ibid.); permission was also asked to maintain the existing offices of each bank.

2/ Apparently, no copy of this judgment was included in the reproduced record. We call this Court's attention to the fact that no notice of appeal was filed subsequent to the final judgment; the Court may wish to consider whether it has jurisdictio to entertain the appeal. See Rules 58 and 73(a), Fed. R. Civ. 28 U.S.C. 1291.

3/ "Pl. Exh." and "Def. Exh." references are to plaintiffs' a defendants' exhibits introduced at trial (see list of exhibits Appendix G to Appellants' Brief, App. 12). These exhibits are not reproduced in the Transcript of Record.

Since the proposed consolidation involved an acquisition of the assets of one national bank by another, and since the resulting bank was to be a national bank, the Comptroller requested reports on the competitive factors involved from the Department of Justice, the Federal Reserve Board and the Federal Deposit Insurance Corporation pursuant to 12 U.S.C. 1828(c)(4). No significant anticompetitive effect was noted by these agencies (see Pl. Exh. 12; Def. Exhs. F, G). The Department of Justice "concluded that the proposed consolidation will not materially alter the competitive situation in either of the areas served by the applicant banks and will not have an adverse effect on competition" (Def. Exh. G).

Appellants, the Superintendent of Banks in Montana and two competing banks located in Butte, commenced this action against the Comptroller on November 23, 1966. The complaint sought a declaration that the proposed maintenance of two offices by the resulting bank violated 12 U.S.C. 36 and 81, and that the consolidation itself violated the Bank Holding Company Act, 12 U.S.C. 1842. It also sought a permanent injunction against approval of the consolidation, a preliminary injunction <u>pendente</u> <u>lite</u>, and a temporary restraining order (I.R. 8). A separate motion for a preliminary injunction and a temporary restraining order was also filed (I.R. 13). First National and Daly then intervened as defendants (I.R. 32).

By agreement of the parties (I.R. 28, 39, 79), the issuance of a final certificate by the Comptroller was postponed, and thus the request for a temporary restraining order was not pursued by plaintiffs. On March 16, 1967, the Comptroller did issue his

decision approving the proposed consolidation. The decision stated in part (Def. Exh. F):

> On consummation of this consolidation, the resulting bank plans to operate the office of the First National Bank of Butte as a branch. By this means, the resulting bank will bring to the area a new banking institution with higher lending limits which will permit the offering of larger credit lines to the community. Home and installment loans, not now offered by the First National Bank of Butte, will be among the services to be offered by the resulting bank and will intensify the competition among the banks located in Butte.
>
> * * * * *
>
> Applying the statutory criteria to this proposal, which appears to be lawful under Federal and State statutes, it is concluded that the proposal is in the public interest and the application is, therefore, approved.

All parties then moved to dismiss or for summary judgmen (I.R. 33, 34, 37). The district court reserved decision on al motions (I.R. 80) and a trial was held. On August 29, 1967, a opinion and order was entered by Judge Russell E. Smith denyin plaintiffs all relief (I.R. 65). The court found as a fact th the consolidation would lead to increased competition in the Butte area (I.R. 52). It held as a matter of law that the mai tenance of separate offices was proper under 12 U.S.C. 36(c) a under State law (I.R. 58-63), and that the Bank Holding Compan Act did not prohibit the consolidation (I.R. 63-65). This appe was then taken (I.R. 66).

Appellants' motion in the district court for a stay pend appeal was denied, since the court found that no irreparable damage would occur from the consolidation and that the public interest would not be served by a stay (I.R. 69-70). This Court (Merrill, Browning and Duniway, JJ.) denied appellants'

urther motion for an injunction pending appeal on October 6, 967, and the final certificate was issued by the Comptroller n October 11. The consolidated bank opened for business on ctober 16, 1967.

STATUTES INVOLVED

12 U.S.C. 36(b)(2) provides in part:

> (2) A national bank (referred to in this paragraph as the "resulting bank"), resulting from the consolidation of a national bank (referred to in this paragraph as the "national bank") under whose charter the consolidation is effected with another bank or banks, may retain and operate as a branch any office which, immediately prior to such consolidation, was in operation as --
>
> > (A) a main office or branch office of any bank (other than the national bank) participating in the consolidation if, under subsection (c) of this section, it might be established as a new branch of the resulting bank, and if the Comptroller of the Currency approves of its continued operation after the consolidation * * *.

12 U.S.C. 36(c) provides in part:

> (c) A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: (1) Within the limits of the city, town, or village in which said assodation is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks. * * *

12 U.S.C. 1842 provides in part:

> (a) It shall be unlawful, except with the prior approval of the Board, * * * (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; * * *.
>
> (d) Notwithstanding any other provision of this section, no application shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted on July 1, 1966, or the date on which such company became a bank holding company, whichever is later, unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication. * * *

Section 5-1021, Revised Code of Montana, provides in part:

> Consolidation of banks. Any two or more banks doing business in this state, may, with the approval of the superintendent of banks, in the case of state banks, consolidate, join and merge into one bank under, into and with the charter of either existing bank hereinafter referred to as the consolidated bank, on such terms and conditions as may be lawfully agreed upon by a majority of the board of directors of each bank proposing to consolidate, and be ratified and confirmed by the consent in writing of the shareholders of each such bank owning at least two-thirds of its capital stock outstanding; provided, that the capital stock of such consolidated bank shall not be less than that required under existing law for the organization of a bank of the class of the largest of the banks so consolidating.
>
> Upon such consolidation the corporate franchise, corporate life, being and existence, and the corporate rights, powers, duties, privileges, franchises and obligations including the rights, powers, duties, privileges and

obligations as trustee, executor, administrator, guardian and all and every right, power, duty, privilege and obligation as fiduciary together with title to every species of property, real, personal and mixed, of such consolidating bank and banks shall, without the necessity of any instrument of transfer, be and become merged and continued in and held, enjoyed and/or assumed by the consolidated bank, and such consolidated bank shall have and enjoy the right equal as to priorities with any other applicant to appointment by the courts to the offices of executor, administrator, guardian and/or trustee under any will or other instrument made prior to such consolidation and by which will or instrument such consolidating bank was nominated by the maker to such office.

Section 5-1028, Revised Code of Montana, provides in part:

> No bank shall maintain any branch bank, receive deposits or pay checks, except over the counter of and in its own banking house.

Section 5-1124, Revised Code of Montana, provides:

> When any two or more banks located in the same county or in adjoining counties shall consolidate in accordance with the provisions of section 5-1021, the consolidated bank may, if it has a paid up capital of seventy five thousand dollars ($75,000.00) or more, upon the written consent of the superintendent of banks and under rules and regulations promulgated by him, maintain and operate offices in the locations of the consolidating banks.

SUMMARY OF ARGUMENT

Appellants make two basic attacks on the approval by the Comptroller of the consolidation of Daly and First National. First, they contend that state law prohibits the maintenance of separate bank offices after the consolidation of two banks. Second, they argue that the Bank Holding Company Act prohibits the consolidation ab initio. As we will show below, the district court correctly held that neither of these contentions is valid. Montana law expressly allows a consolidated bank to "maintain and operate offices in the locations of the consolidating banks," which includes the carrying on of the business of banking in these locations. Mont. Rev. Code 5-1124. And the Bank Holding Company Act, 12 U.S.C. 1842(a)(4), exempts acquisitions of the assets of one bank by another from the terms of the act. State of South Dakota v. National Bank of South Dakota, 335 F. 2d 444, 448-449 (C.A. 8), certiorari denied, 379 U.S. 970.

ARGUMENT

I. MONTANA LAW PERMITS A CONSOLIDATED BANK TO MAINTAIN OFFICES IN THE LOCATIONS OF THE CONSOLIDATING BANKS, AND THESE OFFICES MAY CARRY ON ALL BANKING ACTIVITIES.

Appellants concede, as they must, that "it is now well settled that national banks may maintain branch banks to the same extent as state banks." Appellants' Brief, p. 13; see 12 U.S.C. 36(b)(2), 36(c); First National Bank of Logan v. Walker Bank & Trust Co., 385 U.S. 252. Therefore, the sole question with respect to the maintenance of separate offices

s whether Montana law permits state banks to do what Daly and irst National have been permitted by the Comptroller to do -- .*e*., whether state banks which consolidate may maintain and perate offices in the locations of the consolidating banks for he purpose of carrying on the business of banking.

A. The Express Language Of Section 5-1124 Of The Montana Revised Code Authorized The Action Of The Comptroller In Approving The Consolidation.

In 1927, Montana enacted a law generally prohibiting branch anking. Mont. Rev. Code 5-1028. 4/ Four years later, the egislature enacted Section 5-1124 of the Revised Code of ontana, which provides (emphasis added):

> Maintenance of offices of consolidated banks. When any two or more banks located in the same county or in adjoining counties shall consolidate in accordance with the provisions of section 5-1021, the consolidated bank may, if it has a paid up capital of seventy-five thousand dollars ($75,000.00) or more, upon the written consent of the superintendent of banks and under rules and regulations promulgated by him, maintain and operate offices in the locations of the consolidating banks.

s appears from the plain terms of this Section, the legislative ntent was to allow the consolidated bank to continue to "maintain and operate" its existing "offices" in the places where hey were operating before the consolidation, *i.e.*, "in the locations of the consolidating banks."

Appellants contend, however, that the legislature must be ssumed to have intended to allow something less than the carrying n of a regular banking business in the existing offices, since t "did not use the word branch bank; it used the word office"

/ According to appellants' brief (pp. 18-19), this Act was

(Appellant's Brief, p. 24; emphasis in original). But it is manifest upon analysis that the use of the term "branch bank" would have been inappropriate to effectuate the legislative objective of permitting the existing offices of the consolidating banks to continue to carry on the same banking activities they had conducted before the consolidation. What appellants ignore is that, after consolidation, all of the existing offices cannot logically be termed "branch banks." At least one of them must be a main office, and the others must be, in effect, branch offices. 5/ To be sure, the legislature might have dispelled all possible doubt by providing that: "[T]he consolidated bank may * * * maintain and operate a main office in the location of one of the consolidating banks and branch offices in the location of the other consolidating banks." That it did not do so, however, can give little comfort to appellants. There was no reason for the legislature to foresee appellants' attempt to read the word "offices" as meaning something less than the terms "main office" and "branch office." In common parlance, after all, an office of a bank is a place where the bank conducts the normal business of banking. 6/

4/ (Cont'd from previous page) excluding "relatively sophisticated cities such as Butte * * *." It is therefore unlikely that the legislature, even in enacting this general prohibition agains branching, contemplated a prohibition against consolidating banks in larger cities remaining in the banking business.

5/ Thus, in the instant case, Daly would be considered the mai office, since the consolidation took place under its charter, and First National would be the branch office.

6/ See Appellant's Brief, p. 22, for the text of an Iowa statut allowing the establishment of an "office for the sole and only purposes of receiving deposits and paying checks and for performi other clerical and routine duties not consistent with this sectio Iowa Code Ann. 528.51. Surely the Montana legislature could have

In this connection, it is significant that there are other Montana statutory provisions in which the word "office" is used to connote a place where banking business is carried on. See, e.g., Mont. Rev. Code 87A-4-102, 87A-4-106; compare 12 U.S.C. 36(b)(2); First Hardin National Bank v. Fort Knox National Bank, 361 F. 2d 276, 278 (C.A. 6), certiorari denied, 385 U.S. 959, where the word "office" is used in the same manner. And, in their complaint, appellants use the word "office" four times in this sense (I.R. 3-4, pars. 3, 4, 6, 7). The district court was therefore correct in concluding that "the word 'office' describes a place where banking business is done," "because in Montana, at least, there is no other image of a bank office" (I.R. 60, 61).

B. Appellants' Interpretation of Section 5-1124 Cannot Be Squared With Other Indicia Of The Legislature's Intent.

While we do not believe that this Court need go beyond a consideration of the terms of Section 5-1124 to uphold the determination of the court below, the fact is that there are other concrete indicia of a legislative intent to permit the existing offices of consolidated banks to continue the banking business in which they were engaged at the time of consolidation.

Most persuasive is the fact -- which is understandably totally ignored by appellants in their brief -- that appellant Leuthold, the Superintendent of Banks, after the commencement of this lawsuit, attempted without success to effect the repeal of Section 5-1124 by the State legislature for the purpose of foreclosing this very consolidation. H.B. 509 (Def. Exh. C)

was entitled "An Act To Repeal Section 5-1124 R.C.M. 1947, Relating To Maintenance Of Offices Of Consolidated Banks." Mr. Leuthold appeared before the House Committee on Banking and Industry of the Montana House of Representatives and testified on behalf of H.B. 509 (Def. Exh. B). In urging the repeal of Section 5-1124, he informed the legislators of the proposed consolidation and proposed maintenance of two offices by the consolidated bank in the instant case. He also informed them that Daly and First National claimed authority to operate these offices under Section 5-1124. He gave his opinion that such operation violated Montana law; that, if the consolidation were consummated on the basis set forth in the application, it would have dire results for the Montana banking industry; and that Section 5-1124 was "no longer needed and serves no useful or constructive purpose." He further stated that "if the legislature kills H.B. 509 or does nothing about it, it will have a bearing on the pending court case."

Notwithstanding these representations, the Montana House of Representatives indefinitely postponed H.B. 509 on February 1 1967, upon adoption of the report of the Committee of the Whole. (Def. Exh. C). In these circumstances, it is a reasonable -- if not compelled -- inference that the legislature approved of the maintenance of separate offices after consolidation under Section 5-1124. 7/ This much cannot be disputed: with full

7/ Chapter No. 72, Montana Session Laws 1967, House Bill 205 (Def. Exh. A), passed by the legislature in February, 1967, recognizes that deposit liability may be carried by a Montana bank "at each of its said banking offices" within the state. This is further confirmation that Section 5-1124 was intended to allow full banking facilities to be maintained in each office of the consolidated bank.

nowledge of the reliance of Daly and First National upon Section -1124 and with the Superintendent's express warning that its ction or inaction would have a bearing upon the consolidation f the banks, the legislature nevertheless declined the invita- ion to repeal the Section. There is, therefore, no good reason hy this Court should in effect repeal the Section -- which, as he judge below pointed out, in terms authorizes the consolida- ion. 8/

It should be added that the "horrors" of branch banking llegedly felt by the 1931 Montana legislature (e.g, Appellants' rief, p. 19) are quite beside the point. The consolidation in his case and the maintenance of two offices by the resulting ank leaves the same number of bank offices as were in existence efore the consolidation. Thus, the public will not be deprived f a place in which to do its banking business which existed be- ore the consolidation. With this distinction between consolida- ion and branching in mind, Sections 5-1124 and 5-1028 (the branch anking provision) may easily be reconciled.

/ On September 29, 1966, (just two months prior to the in- titution of this action), the Attorney General of the State of Iontana ruled, in response to a letter from the appellant Super- ntendent of Banks, that consolidating national banks could not aintain more than one office under Section 5-1124 (Pl. Exh. 1). ince 12 U.S.C. 36(c) only refers to "the statute law of the tate" with respect to determining whether national banks should e permitted to operate a branch, administrative opinions should ot be considered. See Union Savings Bank of Patchogue v. Saxon, 35 F. 2d 718, 723 (C.A.D.C.); Howell v. Citizens First National ank of Ridgewood, 385 F. 2d 528 (CA. 3); but cf. Lincoln Bank Trust Co. v. Exchange National Bank, 383 F. 2d 694 (C.A. 10). urthermore, even under Montana law an executive construction of statute is only upheld "if not erroneous." See State v. Schye, 30 Mont. 537, 541, 305 P. 2d 350, 353; compare State ex rel. arr v. District Court, 108 Mont. 433, 436, 91 P. 2d 399, 400. he Attorney General's opinion was properly discounted by the istrict court (I.R. 63).

Section 5-1021, the consolidation section referred to in 5-1124, also demonstrates the intent of the legislature to allo the maintenance of separate offices after consolidation and the exercise of full banking privileges therein. Section 5-1021 pr vides that "the corporate franchise, corporate life, being and existence, and the corporate rights, powers, duties, privileges franchises and obligations * * * of such consolidating bank and banks shall * * * be * * * merged and continued in * * * the consolidated bank * * *." One of the "privileges" possessed by both Daly and First National prior to the consolidation was the privilege of operating a banking office which carried on all banking activities. Section 5-1021, with its broad language co ferring powers upon the consolidated bank, should be viewed as a general grant of authority to the resulting bank to carry on its operations as before, absent a specific prohibition by the legislature. Section 5-1124, far from being a specific prohibi tion, is instead a specific sanction for the consolidated bank to exercise the privilege of the consolidating banks and there- fore to maintain and operate the existing offices in the same way as was done before. When these two sections are read togeth it becomes clear that the legislature intended, as a general matter of banking policy, to allow existing offices to continue to operate as before, and therefore, to continue to provide ful banking services to the public. 9/

9/ Other states have exhibited this same policy of allowing existing offices to remain in operation after consolidation despite a general prohibition against branching. E.g., Utah Code Ann., Title 7, ch. 3, § 6. Where the policy has been to the contrary, the state legislatures have clearly said so. See, e.g. Iowa Code Ann. 528.51, note 6 , supra.

Finally, appellants' construction of Section 5-1124 would render it a nullity. As the court below pointed out, "there is not now, and was not in 1931, any law which forbad banks from maintaining offices wherever they chose so long as they did not conduct a banking business in them" (I.R. 62). Thus, the characterization of Section 5-1124 as allowing offices "for the transaction of business of a routine character, which does not require the exercise of discretion" (Appellants' Brief, pp. 17-18), ascribes to the legislature the intent to allow only that which was already allowed. Such a construction should not be accepted, especially when there is a clear and logical alternate construction.

In summary, the express words of Section 5-1124 allow the maintenance and operation of offices in the existing locations of the consolidating banks, which offices can carry out full banking functions. This interpretation fully squares with the banking policy of the Montana legislature from 1931 to the present. It follows that the Comptroller was acting within his statutory authority in permitting the consolidated bank to maintain the existing offices of the consolidating banks. The district court was clearly correct in upholding the Comptroller's decision.

II. THE BANK HOLDING COMPANY ACT IS INAPPLICABLE WHERE, AS HERE, ONE BANK ACQUIRES ANOTHER BANK.

It is undisputed that the acquisition in question involved the transfer of the assets of First National to Daly (I.R. 55; Pl. Exh. 10). It is also conceded by appellants that Daly "is not a sham entity" (Appellants' Brief, p. 45). Nevertheless,

appellants argue that the Bank Holding Company Act prohibits the acquisition because Daly is owned by Northwest Bancorporation, a bank holding company located in Minnesota. In light of the fact that the relevant portion of the Act, 12 U.S.C. 1842(a)(4), exempts acquisitions by a bank from the terms of the statute, appellants urge this Court to "pierce" the transaction and find a violation regardless of the literal wording of the Act. As we now show, appellants have misconceived the nature of the regulatory scheme, and their argument is therefore without merit.

A. The Bank Holding Company Act Itself Contains An Explicit Exception For The Kind Of Transaction Which Took Place Here.

When a national bank acquires another national bank, as was the case here, the approval of the Comptroller of the Currency is expressly required by statute. 12 U.S.C. 1828(c)(2)(A). Within this regulatory scheme, the Comptroller must also seek the views of the Department of Justice, the Federal Reserve Board and the Federal Deposit Insurance Corporation before approving the acquisition. 12 U.S.C. 1828(c)(4). And, as discussed in Part I, sup when the resulting bank wishes to maintain both of the pre-acquisition offices, 12 U.S.C. 36(b)(2) and 36(c) require the Comptroller to look to state law in order to determine whether the operation of two separate banking offices is proper.

When an acquisition is made by a bank holding company, however, the Federal Reserve Board is the agency charged with approving or disapproving the acquisition. 12 U.S.C. 1842(a). And acquisitions which cross state lines must again be "specifically authorized by the statute laws of the State in which such [acquired] bank is located * * *." 12 U.S.C. 1842(d).

This division of regulatory functions is spelled out in 12 U.S.C. 1842(a)(4) (emphasis added):

> (a) It shall be unlawful, except with the prior approval of the Board, * * * (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank * * *.

This section plainly exempts a bank's acquisition of another bank from the need for approval by the Federal Reserve Board, so that this type of acquisition is only regulated by one agency, the Comptroller of the Currency. 10/ Section 1842(d), therefore, is inapplicable to the instant case, for it is merely "a legislative direction to the Board and does not in any way enlarge on the provisions of (a)." First National Bank in Billings v. First Bank Stock Corp., 197 F. Supp. 417, 422 (D. Mont.), affirmed, 306 F. 2d 937 (C.A. 9). Since approval is not necessary at all in the instant case because of Section 1842(a)(4), the claim that Section 1842(d) prohibits the acquisition in question (Appellants' Brief, pp. 42-44) is without substance.

This reading of the Bank Holding Company Act has been expressly approved by the Court of Appeals for the Eighth Circuit. In State of South Dakota v. National Bank of South Dakota, 335 F. 2d 444, affirming 219 F. Supp. 842 (D.S.D.), certiorari denied, 379 U.S. 970, the State of South Dakota attacked the Comptroller's

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10/ The Federal Reserve Board unsuccessfully attempted to have this exemption deleted from the Act. See Fed. Res. Bull., July, 1958, pp. 787-789; 47th Annual Rep. of the Federal Reserve Board, 1960, pp. 98-99; Hearings on Bank Holding Company Legislation, House Committee on Banking and Currency, 88th Cong., 1st Sess., Vol. 2, pp. 353-362.

approval of the acquisition of the assets of three state banks by a national bank and the maintenance of branches at the existing offices of these state banks. The national bank was owned by a bank holding company. The district court held that "the phrase 'other than a bank' in * * * [12 U.S.C. 1842(a)(4)] creates an exception to the restrictions contained in the remainder of the statute. The exception applies when the assets of a bank are acquired by a bank which is a subsidiary of a holding company." 219 F. Supp. at 853. The Eighth Circuit expressly ratified the conclusion of the district court, and affirmed the approval by the Comptroller (335 F. 2d at 448-449):

> The words in the statute "other than a bank" clearly show the intention of Congress not to require a bank acquiring the assets of another bank to obtain Board approval. The remaining subsections of § 1842, including subsection (d) largely relied upon by the plaintiff, set forth the procedures to be followed where an application to the Board of Governors is required. The words of subsection (d) reading: "no application shall be approved under this section" manifest a Congressional intention that the section only applies to instances where approval of the Board of Governors is required. As Judge Mickelson points out, such interpretation is substantiated by the legislative history and the administrative interpretation of such provisions by the Board of Governors.

It should be noted that, while the court below relied upon the South Dakota decision (I.R. 64), appellants do not even refer to it in their brief. 11/

11/ The attempt to distinguish the South Dakota case by amici curiae (Br., pp. 6-7) is utterly devoid of merit. While it may be that the Comptroller was not a party in South Dakota, the fac[t] remains that the precise sections of the Bank Holding Company Act here involved were given exactly the same interpretation by the Eighth Circuit as urged by the Comptroller in this case.

Appellants clearly cannot prevail in their contention that Section 1842(d) prohibited the acquisition of the assets of First National by Daly in the instant case.

B. <u>There Is No Occasion To View The Consolidation As An Acquisition Of First National By The Holding Company.</u>

Appellants would avoid the clear statutory language of Section 1842(a)(4) by asking the Court to "pierce the corporate veil" and hold that the acquisition was really by Northwest Bancorporation, the bank holding company. However, as we have shown above, the difference in the form of acquisition is the touchstone of the regulatory scheme. The manifest intent of Congress was to regulate bank acquisitions through the Comptroller and holding company acquisitions through the Federal Reserve Board. <u>State of South Dakota</u> v. <u>National Bank of South Dakota</u>, <u>supra</u>, 335 F. 2d at 449. Therefore, the statutory scheme is fully served by appellees' construction of the Bank Holding Company Act.

Appellants' identical contention was made in <u>South Dakota</u>, <u>supra</u> (335 F. 2d at 449):

> Plaintiff urges that the corporate veil should be pierced and that the transaction should be treated as an acquisition by the holding company rather than by the bank. The trial court properly rejected such contention, stating that no subterfuge was here involved. National Bank [the acquiring bank] is a separate corporation. It has held a national charter for many years and is to continue as the surviving bank. It serves a definite corporate purpose, separate and distinct from the holding company. First Bank Stock Corporation has existed as a separate corporation owning stock of national and other banks for a considerable period of time. In this respect, this case differs materially from Whitney Nat'l Bank v. Bank of New Orleans & Trust Co., supra [323 F. 2d 290 (C.A.D.C.), reversed, 379 U.S. 411].

This is precisely the situation in the instant case. Both banks have been in existence for over eighty years. Northwest Bancorporation is an established bank holding company. Thus, the facts in this case are indistinguishable from those in *South Dakota*.

Finally, in a similar case, this Court was asked to "pierc" a comparable veil and hold that the ownership of two banks by a bank holding comapny could cause one bank to act as the branch of the other. This contention was rejected , *First National Bank in Billings* v. *First Bank Stock Corp*., 306 F. 2d 937, and there is no reason for a different result here.

C. Even If The Bank Holding Company Act Were Applicable To The Instant Acquisition, It Does Not Confer Litigable Rights Upon Private Parties Except According To Its Terms, Which Do Not Include Civil Enforcement.

A "party aggrieved" may obtain review of an adverse decision of the Federal Reserve Board under 12 U.S.C. 1848. Otherwise, the Act is enforceable by its terms only through the imposition of criminal penalties under 12 U.S.C. 1847. The Eighth Circuit, in the *South Dakota* case, *supra*, expressly held that private litigants could not invoke the Act in an attempt to invalidate a bank merger, since the criminal provisions were exclusive (335 F. 2d at 447-448; emphasis added):

> The Bank Holding Company Act contains no express provision for civil enforcement. The legislative history of the Act as shown by Judge Mickelson's opinion supports the defendants' view that *Congress intended the criminal enforcement provision to be exclusive.* * * * The history of the legislation is sketched in Senate Report No. 1095, July 25, 1955; 2 U.S. Code Cong. & Admin. News (1956), pp. 2482-2513.

In an earlier proposed Bank Holding Company Bill, S. 310, 77th Congress, express provision is made for civil enforcement of any liability or duty and for injunctive relief.

At various hearings before Congressional committees, Governors of the Federal Reserve System charged with the administration of the Act advocated criminal penalties as the exclusive means for enforcement. Governor Robertson, appearing before the Committee on behalf of the Board on June 24, 1952, stated:

> "Bearing always in mind the desirability of keeping the legislation to a minimum, it is our feeling that the only essential measure of enforcement, and the most effective one, would be a provision for criminal penalties for violation of the statute or of conditions prescribed by the administering agency in granting consent to acquisitions of bank stocks. This would place complete responsibility for enforcement of the law in the Department of Justice. The administering agency would not be placed in a position in which it would be required to institute proceedings for enforcement." Hearings Before the House Committee on Banking and Currency, 82d Cong. 2d Sess., on H.R. 6504 (June 24, 1952), pp. 26-27.

Similar statements were made at subsequent hearings in subsequent years. Hearings Before the Senate Committee on Banking and Currency, 83d Cong., 1st Sess., on S. 76 and S. 1118, p. 17; Hearings Before a Subcommittee of the Senate Committee on Banking and Currency, 84th Cong., 1st Sess., on S. 880, S. 2350 and H.R. 6227 (July 5, 6, 7, 11, 12, and 14, 1955), p. 61; Hearings Before the Committee on Banking and Currency, United States Senate, on Nomination of William McChesney Martin, Jr., 84th Cong., 2d Sess., pp. 36, 37.

Thus it appears that the Act and its legislative history disclose no intent on the part of Congress to create rights to be enforced by civil litigation.

As the above-quoted passage clearly points out, Congress did not intend the provisions of the Bank Holding Company Act to confer litigable rights upon private parties, Therefore,

even if appellants' contentions had some substance (which, as we showed above, they do not), they could not be raised here.

CONCLUSION

For these reasons, the judgment of the district court should be affirmed. 12/

Respectfully submitted,

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MARCH 1968

12/ It should be noted that the instant appeal is not merel from the denial of a motion for a preliminary injunction, but from an order which states (I.R. 65): "On the merits IT IS ORDERED that plaintiffs be denied all relief." Appellees' motions for summary judgment or to dismiss were not granted because a trial on the merits was held and judgment given for defendants-appellees. Thus the entire case is before this Court.

CERTIFICATE

I certify that, in connection with the preparation of his brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in y opinion, the foregoing brief is in full compliance with hose rules.

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AFFIDAVIT OF SERVICE

ISTRICT OF COLUMBIA)
) SS.
ITY OF WASHINGTON)

STEPHEN R. FELSON, being duly sworn, deposes and says:

That on March 21, 1968, he caused three copies of the foregoing Brief for the Appellee to be served by air mail, postage prepaid, upon counsel for appellant and intervenors-appellees as follows:

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Subscribed and Sworn to before me
this 21st day of March, 1968.
[Seal]
Angeline Johns
NOTARY PUBLIC
My Commission expires April 14, 1972.

No. 22202

United States Court of Appeals for the Ninth Circuit

ALBERT E. LEUTHOLD, Superintendent of Banks, State of Montana, Helena, Montana, SECURITY BANK and MINERS BANK OF MONTANA, N.A.,

Appellants,

-vs-

WILLIAM B. CAMP, Comptroller of the Currency,

Appellee.

THE FIRST NATIONAL BANK OF BUTTE and DALY NATIONAL BANK OF ANACONDA,

Appellee-Intervenors.

On Appeal from the United States District Court for the District of Montana

Appellants' Reply Brief

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SUBJECT INDEX

SUBJECT INDEX (Cont.)

CITATIONS

CITATIONS (Cont.)

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On Appeal from the United States District Court for the District of Montana

Appellants' Reply Brief

I.

REPLY TO ARGUMENTS IN APPELLEES' BRIEF

Appellees have raised points in their briefs which require specific reply. Since the main issues of the case fall into three categories:

1. Interpretation of Montana statutes in conjunction with Sec. 36(c) of the National Bank Act;
2. Interpretation of Sec. 36(b) of the National Bank Act; and
3. Interpretation of the Bank Holding Company Act

we shall reply to appellees' points under those headings. Appellees have made additional incidental arguments and we shall deal with them separately.

A. INTERPRETATION OF MONTANA STATUTES

1. *Particular and General Words:*

Intervenor-Appellees rely upon Sec. 93-401-16 R.C.M. 1947 and *Story Gold Dredging Co. v. Wilson,* 106 Mont. 166; 76 P.2d 73. The rule they advance is that in determining the intention of a legislature which has used inconsistent general and particular words, a particular intent will control a general intent when the provisions are inconsistent. Intervenor-Appellees then declare that Sec. 5-1124 providing for *offices* after con-

solidation, shows a particular intent to modify the general intent of Sec. 5-1028, prohibiting branch banking.

We agree. Under 5-1028 no banking facility of any kind could be maintained away from the premises of a bank. Sec. 5-1124 allowed *offices* after consolidation. The specific controls the general. But this rule is of no help in determining what the legislature intended *offices* to include, and that is the issue of this case. The citation of this rule in no way affects the application of the rule relied on by appellants that a legislature is presumed to be aware of statutes already on the books, and when it uses different language in a subsequent, kindred statute, it is presumed to have intended a different meaning.

2. Subsequent Action or Inaction by the Montana Legislature:

Both the Comptroller and Intervenors attempt to imply some legislative intent from the fact that a bill to repeal Sec. 5-1124 failed of passage in the 1967 Legislature. In support of this argument they cite statements made in legislative hearings by one of the appellants, Superintendent Leuthold.

The Supreme Court of Montana has rejected this argument on several occasions. In *Murray Hospital v. Angrove,* 92 Mont. 101, 106; 10 P.2d 577, 583 (1932) the Court held that the controlling intent was the intent

of the legislature that passed the law in question, not the intent of a subsequent legislature that failed to amend or repeal. In this connection the Court said:

> ". . . . It is the contemporaneous action and construction by the legislature to which we may resort in order to determine the intent of that body in enacting a law or rejecting an amendment thereto.
>
> "No case has been cited, or found, holding that the records and journals of subsequent sessions of the legislature have any probative value in determining the intent of the legislature in passing laws already on the statute books, or that the defeat of an attempted amendment to a law which has been on the books for 16 years throws any light on the intent of the assembly which enacted the law.
>
> "But even if the action of the Assembly of 1931 in refusing to amend the Act of 1915 is conceded to be a legislative expression entitled to consideration, the showing made does not disclose legislative 'interpretation' of Sec. 2907, necessarily in conflict with the opinion herein as written. . . . It may be that the attempt was made merely for the purpose of overcoming adverse rulings by the clarification of the Act, and it is as reasonable to assume that the House, in rejecting the amendment, determined that it was so 'plain, simple, direct and unambiguous' as to require no interpretation or clarification."

The case is squarely in point and has been followed in *Trudgen v. Trudgen,* 134 Mont. 174, 329 P.2d 225 (1958) and *Montana Power Co. v. Vigilante Electric Co-op,* 143 Mont. 119, 387 P.2d 718 (1963).

Bottomly v. Ford, 117 Mont. 160, 157 P.2d 108 (1945) and *James v. V.K.V. Lumber Co.,* 145 Mont.

466, 401 P.2d 282 (1965), cited by appellees, are not in point.

3. OFFICES — the Use of the Plural in Sec. 5-1124 as an Indication of Intent by the 1931 Legislature:

Appellees' argue (Comptroller's Br. 9; Intervenors' Br. 12) that Sec. 5-1124 provides for the operation of " 'office*s*' at the 'location*s*' of the 'consolidat*ed* bank' ", and that "one such 'location' will, of course, be the main banking 'office' of any such consolidated bank." (Emphasis added) The flaw in this argument lies in the use of the words "consolidated bank" when the statute uses the words "consolidat*ing* banks". The distinction is significant, and appellees' argument exhibits an inexcusable misreading of the statute involving consolidation.[1]

To read Sec. 5-1124 correctly it is necessary to consider Sec. 5-1021, R.C.M. 1947, the consolidation statute which was in existence in 1931 as part of the banking code of 1927. This statute authorizes the consolidation of two or *more* banks. The resulting organization (or perhaps the bank doing the taking in — the statute is not clear) is designated in the statute as the "consolidat*ed* bank".

The bank, or banks, taken into the charter are designated in the statute as the "consolidat*ing* banks." When

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1 Sec. 5-1021, quoted at p. 6 of our original brief.

5-1124 came along four years later it provided that after consolidation, the consolidat*ed* bank (the one with the charter) can maintain "offices" (if more than one bank is consolidat*ing*, i.e., being taken in) in the location of the consolidating bank or banks.

Obviously the term "offices" in the plural has no reference to the consolidat*ed* bank; it only refers to the consolidating bank or banks.

4. Leuthold Statement to 1967 Legislature:

Both appellees devote considerable attention to Mr. Leuthold's statement to the 1967 Montana Legislative Committee. Despite its complete irrelevance to a determination of what the 1931 Legislature intended when it used the term "offices" in Sec. 5-1124,[2] they have seized upon it as though it were an admission against interest. They argue that because of Mr Leuthold's statement, and the 1967 Legislature's failure to repeal 5-1124 when he had endorsed repeal, a new legislative intent has been superimposed upon Sec. 5-1124: to-wit, that "office" means "branch bank".

As we have shown above, the correct rule in Montana is that action or inaction of a subsequent legislature has no bearing on the legislative intent of a previous

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2 **Murray Hospital v. Angrove, supra.**

legislature. Aside from that, appellees do not tell the whole story of what was before the legislative committee in 1967. House Bill 509 was opposed by lobbyists for intervenor-appellees, who filed a statement with the committee (Plaintiff's Exhibit 2). In this statement the legislators were urged to do nothing about the bill and "to let the banks settle their own lawsuits" and "if, in fact, they [appellants] have a valid, legal reason to oppose this consolidation in court, then the legislature has nothing to settle."

If the statements of Leuthold or intervenors' lobbyists have probative value in determining the legislative intent of the 1967 Legislature, it can be said with equal force that the Legislature decided to "let the courts decide" what was intended in 1931, or even that the combined statutes needed no clarification because they effectively prevented branch banking after consolidation.

5. Comptroller's Existing Offices Argument:

The Comptroller takes liberties with Sec. 5-1124 when he paraphrases the statute (Br. 9) as allowing "the consolidated bank to *continue* to 'maintain and operate' its *existing* 'offices' *in the places where they were operating before the consolidation*, i.e., 'in the locations of the consolidating banks'." (Emphasis added to the objectionable additions supplied by the Comptroller) If

offices were described in the statute as "existing" and if the statute allowed the consolidated bank to "continue" to maintain, and if the statute spelled out that the offices should be "in the places where they were operating before the consolidation," then the Comptroller might have an argument. But the statute obviously contains none of this material. The Comptroller creates the statute to his own liking and, having done so, he sprinkles his "existing offices" idea throughout his brief just as though it were valid (Br. 9, 10, 11, 14, 15).

B. INTERPRETATION OF SEC. 36(b), NATIONAL BANK ACT

1. General Aim of Competitive Equality by Congress Does Not Repeal or Amend Sec. 36(b) or (c):

Appellee and Intervenors argue as to the effect of our admission of competitive equality (Appellees' Br. 8, Intervenors' Br. 24). We do admit that the general aim of Congress over the past 41 years has been competitive equality between national and state banks in the maintaining of branches. That aim was not attained in any one year. Complete equality has not yet been attained. In its move toward such equality, Congress has taken three different legislative steps.

Step 1. The McFadden Act of 1927. National Banks were authorized only to operate "inside" branches

in the municipalities in which the main banking facilities were situated (*First National Bank of Logan, Utah, v. Walker Bank & Trust Company,* 385 U.S. 252, 87 S.Ct. 492, 17 L.Ed 2d 348). Some state banks had a competitive advantage. They could maintain branches outside of such municipalities.

Step 2. The 1933 amendment to Section 36(c) permitted national banks to establish branches outside of the municipalities in which their main offices were located (*Walker Bank* case, supra), but some state banks still could retain branches in circumstances where national banks could not do so.

Step 3. In 1962 Section 36(b) was enacted. The Comptroller testified this amendment was intended to cover only a few technical situations in certain states (Appellants' Br. 32-34). The Montana Sec. 5-1124 is unique (Appellants' Br. 21). The 1962 amendment was not aimed at the Montana situation.

Step 4. This step has not yet been taken. Congress has not changed Section 36 to meet our unique Montana law. This Court must determine if Montana law allows a state bank in Anaconda to establish and operate a "new branch" in Butte. The maintenance of an existing bank under Sec. 5-1124 is not the equivalent of the establishment and operation of a *new* branch.

2. Plain Language of Section 36(b):

Intervenors argue that the Butte bank never has been a branch and so should be classed as a "new" branch of the resulting bank (Intervenors' Br. 23). That ignores the plain wording of the statute. Section 36(b) provides a resulting bank may *"retain and operate"* the Butte bank as a branch only if it might be *"established"* as a new branch under Section 36(c). From 1933 to the present, Section 36(c) has set the standards under which a national bank may *"establish and operate new branches."*

If the newness of the branch to the resulting bank were the test, then the 1962 amendment was unnecessary as to the main office or branches of banks participating in any consolidation. Such main office or branches all would be "new" to the resulting bank, even though they were existing facilities which were being retained rather than established as new branches. Newness is not the test. *The test is whether Montana law allows the establishment and operation of a new branch in the absence of consolidation.*

3. Presentation to the Trial Court:

Intervenors argue that this Court should not consider Section 36(b) because the theory was not presented to the trial court (Intervenors' Br. 27). That is inaccurate. The theory is set forth in Appellants' Com-

plaint by pleading of the statutes in question (Section I of Appellants' Complaint states that the action arises under 12 U.S.C., Sec. 36; and paragraph 10 of Section V quotes Sections 36(b) and (c) at length. Paragraph 14 of Section VI of the Complaint further sets forth the contentions with regard to Section 36). The quotations on this theory in Appellants' Brief are from sources of which this Court takes judicial notice. Clearly all parties had knowledge of this theory of Appellants' case.

4. *Appellees' Inconsistency:*

Appellees assert the need to apply the philosophy of competitive equality to evade a literal reading of Sec. 36(b). Later in their brief they ignore the philosophy of the Bank Holding Company Act to limit concentration of banking power, and *insist* on a literal reading of Sec. 3(a) of that act.

C. INTERPRETATION OF BANK HOLDING COMPANY ACT

1. *South Dakota Cases:*

Appellees attempt to defend against the declared and evident intent of the Congress to prohibit the expansion of bank holding companies across state lines by relying upon the South Dakota cases.[3]

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3 State of South Dakota v. National Bank of South Dakota, 219 F. Supp. 842 (D.S.D. 1963) 335 F2d 444 (8th Cir. 1964).

Strictly speaking, the courts in *South Dakota* held only that the State of South Dakota had no standing to attack the acquisition of a bank by a bank holding company subsidiary bank. It is true that after deciding the case on the narrow ground of standing to sue, both the District Court and the Court of Appeals undertook to interpret the Bank Holding Company Act.

Appellants of course disagree with *South Dakota,* both on its decision as to standing and on its interpretation of the Bank Holding Company Act. It will serve no purpose here to reassert at length the arguments of our original brief as to legislative history, congressional intent and piercing the corporate veil. All of these matters were before the Court in *South Dakota.*

However, there is nothing sacrosanct about a decision by a court of appeals of another circuit. The District Court in the case at bar declined to follow *South Dakota* on the standing to sue question, holding (R. 57) that the action of the Comptroller was properly reviewable in a suit by the Montana Superintendent of Banks and by aggrieved competitiors. Nor did the District Court in the case at bar follow *South Dakota's* observations on the exclusivity of the criminal remedy (R. 57). Both of these questions were involved in the basic "threshold issue" of *South Dakota.* Appellants suggest that *South Dakota* might just as well be in error on non-

threshold issues, as to which its observations are only dicta.

The Comptroller suggests that *South Dakota* is authority here, notwithstanding the fact that the Comptroller was not a party in *South Dakota* (Br. 18, fn. 11). But is that so? Banks are commercial enterprises and cannot be strictly judged for taking advantage of possible inconsistencies in a statute. The Comptroller, on the other hand, is a public official with the duty of proper interpretation of the banking laws. He is charged with a duty not to act arbitrarily or capriciously. Appellants submit that when the Comptroller approves a consolidation contrary to the manifest intent of Congress he is acting arbitrarily and capriciously.

D. ADDITIONAL ARGUMENTS

1. Appendix Material in Appellants' Original Brief:

This case was presented to the District Court on cross-motions for summary judgment and motions to dismiss. The only trial was on the question of jurisdictional amount and damages. The material in the appendices of Appellants' Brief is material of which an appellate court can properly take judicial notice.[4]

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4 **N.L.R.B. v. Atkins, 331 U.S. 398, 406; 67 S.Ct. 1265; Tucker v. Texas, 326 U.S. 517, 519; 66 S.Ct. 274.**

2. Failure to Appeal from Nunc Pro Tunc Order:

Rule 58 FRCP, requires the Clerk of the District Court to prepare a Judgment in a case such as this. The Clerk in this case failed to do so. Immediately upon the Court's decision in the matter Appellants filed Notice of Appeal. A considerable time thereafter the District Court, with this Court's concurrence filed a Judgment Nunc Pro Tunc. In the period between the filing of Notice of Appeal and the Nunc Pro Tunc Judgment, Appellants had before this Court a Motion for Injunction Pending Appeal, and no point was made by Appellees that no proper appeal had been filed. Appellee-Comptroller sought and was granted, with Appellant's consent, additional time to file his brief.

The District Court's order for entry of Nunc Pro Tunc Judgment specifically referred to the premature appeal and the possible necessity of validating it by means of a judgment entered nunc pro tunc. This Court, by Judges Hamley, Merrill and Koelsch, specifically approved the District Court's order to enter judgment as of a date prior to the Notice of Appeal.[5]

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5 See **Carter v. Campbell**, 285 F.2d 68 (1960) 5th Circuit, a case in which an appeal from an opinion was allowed, on the acquiescence of appellee and without a Nunc Pro Tunc Judgment.

3. *Intervenor-Appellees' Proposed Exhibits C and D:*

Proposed Exhibits C and D are newspaper accounts concerning the statement of one legislator in 1931 about the passage of Sec. 5-1124. The exhibits were rejected by the trial court after an objection of hearsay (Tr. 212). The exhibits were evidently offered to show legislative intent. In that role they are patently inadmissible because the expression of one legislator can have no bearing on legislative intent. They are inadmissible as double hearsay: hearsay on the part of the news reporter, hearsay on the part of the printer. The District Court properly rejected the exhibits.

4. *Standing to Sue:*

The District Court properly held that all parties have standing to bring this case.

In the case of Superintendent Leuthold there is a conflict of authority; intervenor-appellees rely on the *South Dakota* cases, supra. Appellants rely on *Jackson v. 1st National Bank of Valdosta,* 349 F.2d 71, (5th Cir. 1965). The District Court held that Leuthold had standing (R. 57).

In *Jackson v. 1st National Bank of Valdosta,* the Court of Appeals held that the Georgia Superintendent of Banks had standing to bring an action against a na-

tional bank to enjoin it from operating an illegal branch, reasoning, at 349 F.2d 75, that:

> ". . . . The subsumption of state substantive law as the regulating principle for national banking associations concerning branching carries with it the right of the State Superintendent of Banks to see to it that substantive law is enforced."

If the State of Montana, through its duly appointed Superintendent of Banks, is without standing to enforce its own laws on branching against national banks, the principle of competitive equality is destroyed. Leaving the enforcement of state laws on branching against national banks solely to the Comptroller of the Currency is patently insufficient to protect the congressional policy of equality between state and federal banks.

5. Civil Jurisdiction Under the Bank Holding Company Act:

Related to Superintendent Leuthold's standing to sue is Appellees' contention that the Bank Holding Company Act is a criminal act and that the propriety of the Comptroller's decisions as to holding company acquisitions cannot be tested in a civil suit.

It is true that the Bank Holding Company Act is criminal in nature in that it provides for a penalty for its violation, and that 12 U.S.C., Sec. 1848 provides that a party aggrieved by an order of the Board of Governors of the Federal Reserve may obtain a review in the U. S.

Court of Appeals. We point out, however, that the Federal Reserve Board did not, and does not, pass on consolidations such as this, so no review could be had in a Court of Appeals in a case such as this where only the Comptroller acts (see *South Dakota,* supra, 219 F. Supp. 842 at 853). It is the action of the Comptroller for which review was sought in the District Court in this case. His actions are clearly reviewable under 5 U.S.C., Sec. 702.[6]

6. *Competitive Effect:*

The Comptroller states in his statement of the case that no significant anti-competitive effect because of the consolidation and branching was noted by the Department of Justice, the Federal Reserve Board, and the Federal Deposit Insurance Corporation. Appellants note this statement only to point out that the competitive investigation made by those agencies has only to do with potential monopoly, (12 U.S.C., Sec. 1828(5)) and has nothing to do with the jurisdictional amount or injunction elements of this case.

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6 **Whitney National Bank v. Bank of New Orleans,** 379 U.S. 411, 85 S.Ct. 551 (1965) is not contrary. In **Whitney,** the Comptroller's action was sought to be reviewed under the Administrative Procedure Act. The Court held that since the Federal Reserve Board had acted, review was limited to that provided by the Bank Holding Company Act. The Court left the door open for a review of the Comptroller's action in a proper case: a case in which it was the only action that was taken. For other cases in which actions of the Comptroller have been reviewed under the Administrative Procedure Act, see **First National Bank of Smithfield v. Saxon,** 352 F.2d 267; **Peoples Bank of Trenton v. Saxon,** 244 F.Supp. 389; **Bank of Sussex County v. Saxon,** 251 F.Supp. 132; **American Bank & Trust Co. v. Saxon,** 373 F.2d 283.

II.
CONCLUSIONS

Much of the foregoing is necessary legal quibbling. It is the minutiae upon which cases sometimes turn. Once raised it cannot be ignored, out of fear that if ignored it will decide the case adversely. Appellants are confident that they are properly in court to test the action of the Comptroller under the National Bank Act, the Bank Holding Company Act, and the Administrative Procedures Act, and that they are correct in their legal interpretations of the statutes involved.

But the large issues in the case are whether the philosophy of competitive equality between national and state banks be preserved, and whether the philosophy underlying the Bank Holding Company Act (the prevention of undue concentration of banking and financial power)[7] be enforced. It seems to Appellants that these issues must be resolved in their favor.

It is no answer to the competitive equality problem to say that if this court allows branching in Montana for national banks, state banks will thereafter be able to meet the competition by branching. True, state banks would have the technical, legal ability to consolidate and branch, but they would not have the same eco-

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7 102 Cong. Rec. 6857 (1956).

nomic and geographic opportunities.[8] Outside holding companies have banks in every city of any consequence in Montana, and their counties of domicile touch nearly every county in Montana. If the District Court's decision is allowed to stand it will be geographically and economically possible for three out-of-state holding companies to control a substantial percentage of banking power in Montana. Myriad small country banks, both state and national, will have only two choices: to become a branch or to compete with a branch. And that will surely follow, as the night the day.

This is not a question of whether or not one favors branch banking. Montana is philosophically on record as opposing it. If the consequences of the District Court's decision are as we suggest (and in a case as important as this, that assumption must be made) then it cannot be said that the 1931 legislature intended to allow full scale branches after a consolidation. If that was its intent it would simply have repealed the non-branching statute.

This case involves three laws, each of which expresses something more than a regulation or a prohibition. Each expresses a policy, a philosophy. The case should not be judged on narrow questions of whether or

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8 It should be borne in mind that consolidation is possible only in the same or contiguous counties.

not a loop-hole has been successfully found and got through, on what one legislator said to another, or on one man's image of the legislature's image of banking.

It appears conclusive to Appellants that Montana is opposed to branch banking; that all future activities of bank holding companies have been confined by the Congress to their home states; and that when Congress imposed the rule of competitive equality it intended equality in fact and not form.

The District Court should not be reversed.

Respectfully submitted,

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CERTIFICATE

JOHN M. SCHILTZ, one of counsel for Appellants, states as follows:

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing Brief is in full compliance with those rules.

....

JOHN M. SCHILTZ
Attorney for Appellants

CERTIFICATE OF SERVICE

I hereby certify that Appellants' Reply Brief has been served by mailing three copies thereof to each of the following counsel of record in this cause: Moody L. Brickett, United States Attorney for the District of Montana, Federal Building, Butte, Montana 59701 and Stephen R. Felson, United States Department of Justice, Appellate Section, Civil Division, Washington, D. C., Attorneys for Appellee; and to McKeon and Brolin, 122-126 Oak Street, Anaconda, Montana 59711, Johnson & Johnson, 1st National Bank Building, Butte, Montana 59701, and John D. French, 1260 Northwestern Bank Building, Minneapolis, Minnesota 55402, Attorneys for Intervenor-Appellees.

Dated April ...., 1968.

....

JOHN M. SCHILTZ
One of Counsel for Appellants

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22202

ALBERT E. LEUTHOLD, SUPERINTENDENT OF BANKS, STATE OF MONTANA, HELENA, MONTANA, SECURITY BANK AND MINERS BANK OF MONTANA, N. A.

Appellants

vs.

WILLIAM B. CAMP, COMPTROLLER OF THE CURRENCY

Appellee

THE FIRST NATIONAL BANK OF BUTTE AND DALY NATIONAL BANK OF ANACONDA

Intervenors

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA, BUTTE DIVISION

AMICI CURIAE BRIEF OF INDEPENDENT BANKERS ASSOCIATION OF MONTANA, WESTERN INDEPENDENT BANKERS, AND INDEPENDENT BANKERS ASSOCIATION OF AMERICA

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INTEREST OF AMICI CURIAE

Amici are associations of independent, locally owned, national and state banks. The Montana Association repre-

sents 69 banks, the Western Association represents 369 banks in nine Western states, and the National Association represents over 6,600 banks in the remaining 41 states, including Montana. These Associations are organized to represent the interests of independent unit banking, which includes the preservation of competition in banking, and the prevention of concentration of control of banks in Montana and elsewhere.

The Western Association and the National Association jointly sponsored in Congress the legislation now known as the Bank Holding Company Act of 1956. At the time this legislation was considered in Congress, holding companies were spreading rapidly, especially in states prohibiting or restricting branching. In the House of Representatives, the original legislation was designed to bar interstate expansion of holding companies and to restrict severely expansion within the home state of a holding company. The Senate version was more moderate, and was designed to carefully screen through the Federal Reserve Board any further acquisitions by these companies.

A serious defect in the Senate version was the omission of a prohibition against holding companies expanding across state lines. The Western and National Associations vigorously supported and were successful in obtaining in Congress the "Douglas Amendment" (12 *U.S.C.* § 1842 (d)), the intended purpose of which was to flatly prohibit any expansion by bank holding companies across state lines.

The Bank Holding Company Act was enacted to prevent such expansion, as will be shown from the Reports of Congressional Committees. The device used by the intervening banks, if permitted, would defeat the intended

purpose of preserving competition and preventing concentration in the field of banking.

The *Amici* Associations appreciate the Court's leave to file this brief.

STATEMENT OF THE CASE AND SPECIFICATION OF ERRORS

For the purpose of this brief *Amici Curiae* adopt the statement of facts and specification of errors contained in the brief of Appellants.

ARGUMENT

I.

THE COMPTROLLER'S DECISION IS REVIEWABLE UNDER THE ADMINISTRATIVE PROCEDURE ACT.

A. The State Superintendent of Banks Has Standing.

The lower court held that as the primary enforcement officer of state banking laws, the Superintendent of Banks has standing to sue to review under the Administrative Procedure Act the decision of the Comptroller of the Currency approving the merger of the intervening banks. This decision is now strongly undergirded by the decision of the Court of Appeals for the District of Columbia in the case of *Nuesse v. Camp,* 385 F.2d (1967).

As in other federal banking statutes, Congress in the Douglas Amendment to the Bank Holding Company Act 12 *U.S.C.* §1842(d)) deliberately deferred to the laws of the states. The pertinent part of the Douglas Amendment is to the effect that acquisition of "all or substantially all of the assets of *any* additional bank located *outside* of the

State . . ." in which the holding company has its office, or principally conducts its operations, is prohibited, "unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the state in which such bank is located, by language to that effect and not merely by implication" (12 *U.S.C.* §1842(d)). (Emphasis added.) There is no question that Montana has no such statute and that Minnesota is the home state of Northwest Bancorporation because it has its principal office in Minnesota and its total deposits in subsidiary banks in Minnesota are greater than in any other state in which it operates.

This deliberate deference by Congress to the State law follows the same pattern as contained in the branching law (12 *U.S.C.* §36(c)). This deference to state law, in fact, has been a constant policy of Congress in all of the basic areas of banking.[1]

The rationale of using state laws to govern national banks competing with state banks in each state recognizes that the states have widely varying economies. What is suitable for a densely populated industrialized state is not necessarily suitable for an agricultural state. Neither Federal nor State governments have the constitutional right to pre-empt the chartering and regulation of banks and they

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[1]See e. g. the measure of allowable capitalization of new national banks, *31 Stat.* 48 (1900), *12 U.S.C.* §51 (1935); as to interest rates on loans, *48 Stat.* 191 (1933), *12 U.S.C.* §84 (1935); as to securing public money deposits, *31 Stat.* 1448 (1901), *12 U.S.C.* §90 (1950); as to trust powers, *76 Stat.* 668 (1962), *12 U.S.C.* §92a(a) (1962); as to conversion of a national bank to a state bank, *64 Stat.* 456 (1950), *12 U.S.C.* §214c (1954); as to interest on demand deposits, *48 Stat.* 181 (1933), *12 U.S.C.* §371a (1935); as to interest on savings deposits, *12 U.S.C.* §371 (1933), and as to taxation of national banks, *13 Stat.* 111 (1864), *12 U.S.C.* §548 (1926). See *Franklin Nat'l Bank of Franklin Square v. People of State of New York,* 347 U. S. 37 (1954), where the Court notes some of these areas of equalization.

must, therefore, share the field and provide an accommodation between the two systems so that one does not obtain an advantage over the other. Congress has avoided a monolithic system of banking for the country and has used state laws as guides for national banks operating in the various states.

In the Douglas Amendment Congress provided that holding companies cannot acquire banks in another state unless that other state adopts a statute specifically permitting it. Montana has not seen fit to adopt such a law and the State Superintendent in Montana has the right to vindicate the choice his state has made, namely, to rely upon the Douglas Amendment to prevent such acquisitions.

Further, Congress provided in Section 1846 as follows:

> The enactment by the Congress of this chapter shall not be construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to banks, bank holding companies, and subsidiaries thereof.

B. The Comptroller's Decision Is Subject to Review under the Administrative Procedure Act.

We agree with the lower court that the decisions of the Comptroller, whenever they involve an alleged violation of the state law, are subject to review under the Administrative Procedure Act (APA).

The APA grants to the federal courts a wide scope of review of agency actions. In its pertinent part, the APA states that

> . . . the reviewing court shall . . . (2) hold unlawful and set aside agency action, findings and conclusions found to be

> (A) . . . not in accordance with law; . . .
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right. . . . (5 *U.S.C.* §706).

There is no question that the office of the Comptroller of the Currency is an "agency" within the definitions in the APA (5 *U.S.C.* §§551, 701).

Appellants are proper parties and have standing to maintain an action for review under the APA. 5 *U.S.C.* §702 states that "a person suffering legal wrong . . . or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." The word "person" as defined in the APA includes all of the appellants herein. The phrase "relevant statute" applicable in the instant case is the Douglas Amendment.

The appellants are adversely affected and aggrieved because the Comptroller has approved expansion of a foreign holding company within the state of Montana. The expansion presented by the facts in this case and any further expansion, if permitted, will be to the detriment of nonholding company banks because the holding company system in Montana will thus be able to increase its competitive advantage over independent unit banks.

Section 704 of the APA gives the court the authority to conduct this review.

C. The South Dakota Case Is Distinguishable.

A case similar to the instant case was decided by the Court of Appeals for the Eighth Circuit in 1964. *State of South Dakota v. National Bank of South Dakota,* 335 F.

2d 444. In that case the state sued the holding company and its subsidiary directly, alleging violations of the National Bank Act and the Bank Holding Company Act. It was not an action for review and the Comptroller was not a party. In the instant case, the state and competing banks are challenging the agency action of the Comptroller in approving the consolidation of a holding company subsidiary bank and another bank within the framework of the APA.

In the *South Dakota* case, the Court held that the Holding Company Act provided only a criminal remedy. However, notwithstanding the criminal remedy provided in the Act, courts have the inherent power to restrain statutory violations where a criminal remedy would be inadequate or inappropriate. See, e g., *28* Am. Jur., *Injunctions* §160. Further, the criminal enforcement section of the Act (*12 U.S.C.* §1847) provides penalties only for *willful* violations of the Act. If construed literally any good faith attempt by a foreign holding company to expand across state lines would not be willful and thus there would be no remedy whatever under the Holding Company Act.

The broad coverage of the APA provides an adequate remedy in this case. If this Court finds that the Douglas Amendment prohibits any expansion by a holding company across state lines by whatever device, the Comptroller had no authority to approve the consolidation. This is so because the Comptroller, in exercising discretion under the Merger acts (12 *U.S.C.* §§215, 1828(c)) is bound by all federal banking laws.

II.

THE DOUGLAS AMENDMENT (12 U.S.C. § 1842(d)) BARS THE CONSOLIDATION.

A. The Legislative History of the Bank Holding Company Act Furnishes Important Insights Into the Intent of Congress.

The legislative history of the Bank Holding Company Act of 1956 shows clearly that Congress was convinced that bank holding companies were thwarting national banking policy, that they posed a threat to competition in banking, and that immediate controls were urgently required.

Following are excerpts from House Report No. 609 84th Cong. 1st Sess. May 20, 1955, House Misc. Reports, Vol. 3:

> "The need for immediate legislation which would at the same time control the future expansion of bank holding companies and force them to divest themselves of nonbanking business has been established to the complete satisfaction of your committee."

* * * * *

> "Evidence developed during the hearings has convinced your committee that bank holding companies are not in accord with the very precepts upon which our banking system rests. The United States early in its history, it should be recalled, adopted a democratic ideal of banking. Other countries, for the most part, have preferred to rely on a few large banks controlled by a banking elite. There has developed in this country, on the other hand, a conception of the independent unit bank as an institution having its ownership and origin in the local community and deriving its business chiefly from the community's industrial and

commercial activities and from the farming population within its vicinity or trade area. Its activities are usually fully integrated with local economic and social organization. *The bank holding company device threatens to destroy this democratic grassroots institution.*"

*   *   *   *   *

"*Your committee believes that the destruction of the American unit banking system, resulting in the further concentration of credit facilities, would have revolutionary effects upon our free-enterprise system. Ultimately, monopolistic control of credit would entirely remold our fundamental political and social institutions.*"

*   *   *   *   *

"The time for action is now. We dare wait no longer, for already we are rapidly following the example of England whose many banks became the Big Five."

"While our banking structure has evolved down through the years to meet changing economic requirements, this country has held steadfast to the doctrine that competition should prevail in the banking industry. *Our national banking policy has aimed at protecting and fostering the growth of independent unit banks.*"

*   *   *   *   *

"*Your committee believes it is obvious that the declared will of Congress in favor of independent competitive banking is being thwarted by indirect branch banking, through the mechanism of the holding company.*"

*   *   *   *   *

"*Your committee should like to reemphasize the fact that this is the only country left where most communities are served by home-owned and home-managed banks which are aware of and responsive to the needs of the people of their areas. Our independent banking*

system has been a vital factor in the development of the United States."

*   *   *   *   *

"The holding company device lends itself readily to the amassing of vast resources obtained largely from the public, which can be controlled by the relatively few who comprise the management of the holding company, giving them a decided advantage in acquiring additional properties and in carrying out a program of expansion. Such power can be used to acquire independent banks by measures which leave local management and minority stockholders little with which to defend themselves except their own protests. . . . (Emphasis supplied.)

This House Report was followed, in the second session of the 84th Congress, by Senate Report No. 1095, 84th Cong. 2nd Sess. pp. 248 et seq., from which we quote the following pertinent excerpts:

"In the opinion of your committee, public welfare requires the enactment of legislation providing federal regulation of the growth of bank holding companies and the type of assets it is appropriate for such companies to control."

*   *   *   *   *

"The dangers accompanying monopoly in this field are particularly undesirable in view of the significant part played by banking in our present national economy."

*   *   *   *   *

"The factors required to be taken into consideration by the Federal Reserve Board under this Bill also require contemplation of the *prevention of undue concentration* of control in the banking field to the detriment of public interest and the encouragement of

competition in banking. *It is the lack of any effective requirement of this nature in present Federal laws which has led your committee to the conviction that legislation such as that contained in this bill is needed.*" (Emphasis supplied.)

The statement of national policy in connection with holding company legislation is underscored by similar statements in connection with the Bank Merger Act adopted four years later.

Following are excerpts from House Report No. 1416 (U. S. Code, Cong. & Adm. News, 86th Cong., 2nd Sess., 1960, p. 1995 et seq.) on the 1960 amendment controlling bank mergers and acquisitions of bank assets. 12 *U.S.C.* §1828 (c).

> "Vigorous competition in banking stimulates competition in the entire economy, in industry, commerce, and trade. There is no question that competition is desirable in banking, and that competitive factors should be considered in all aspects of the supervision and regulation of banks."
>
> * * * * *
>
> "The number of commercial banks in the United States has been slowly but steadily declining in the past ten years."
>
> * * * * *
>
> "This occurred in spite of a tremendous increase in the country's need for banking services."
>
> * * * * *
>
> "The large numbers of mergers in recent years, the vast resources involved in these mergers, and the increases in the size of large banks, particularly those which have grown through mergers, all give rise to concern for the maintenance of vigorous competition in the banking system and in the industry and com-

merce served by the banking system. The reduction in the number of banks and the loss of competition between merged banks also give rise to concern."

* * * * *

"Sad experiences in our history have demonstrated that to maintain a sound banking system in this country banks must be regulated much more strictly than ordinary businesses."

B. The Legislative History of the Douglas Amendment Shows It Was Intended as an Absolute Bar to Interstate Expansion of Holding Company Systems.

The House Bill proposed that holding company expansion across state lines be barred absolutely and that expansion within the home state be severely restricted. The report stated:

> Section 5 further provides that in no case could further expansion outside of the home State of a bank holding company or a subsidiary thereof be approved and applications within the home State could be approved only within the area within which branches of banks are permitted or where by State statute such expansion is specifically exempted from branch banking restrictions. H.R. Rep. No. 609, *supra,* 15.

The Senate Banking Committee modified the House version as to holding company expansion within its home state, but did nothing specific as to the expansion across state lines. (See S. Rep. No. 1095, 84th Cong., 2d Sess. (1956).) Many senators considered this omission a serious defect in the bill and Senator Douglas offered his amendment (now Section 1842(d)) with the intent of barring absolutely any

expansion of holding companies across state lines. After adoption of the amendment by the Senate, it was adopted without change by the House.

The debate in the Senate on April 24, 1956, from the time of introduction of the amendment to the roll call vote, is recorded in seven pages of the Congressional Record for that day. 102 Cong. Rec. 6857-6864 (1956), set out in full in Appendix A to this brief. At the outset Senator Douglas stated:

> Mr. President, the pending bill, and the amendment which has just been read, are in the true American tradition, for what the sponsors of the amendment are seeking to do is to prevent an undue concentration of banking and financial power, and instead to keep the private control of credit diffused as much as possible. 102 Cong. Rec. at 6857.

In reply to questions, Senator Douglas stated that all he was trying to do was

> to prevent bank holding companies from expanding across State lines, unless the States give them explicit permission to do so. *Id.* at 6859.
>
> * * * * *
>
> However, so far as the bank holding companies are concerned, I want to check their expansion. This seems to me to be about the best way of doing so. *Id.* at 6860.

Senator Bricker, the chief opponent of the amendment, clearly understood that the amendment was intended to be an absolute bar against holding company expansion across state lines, regardless of the provisions of any other part of the Act. He said:

> The Douglas amendment prohibits the acquisition of

> a bank outside the home State of a bank holding company unless the laws of the State to be entered specifically authorize such acquisition. I submit, Mr. President, that no State in this country has enacted laws along this line. So the effect of the Douglas amendment is to absolutely prohibit a bank from crossing State lines. *Id.* at 6881.

Senator Payne, a supporter of the amendment, understood the evils to be put down by this amendment.

> Through its ability to cross State lines, the bank holding company can operate in a way closed to the independent bank. The competition presented by a single bank which is a subsidiary of a bank holding company may not in any legal sense be unfair competition, but the fact that it is backed by the powerful assets of a vast bank holding company gives it a competitive advantage that is undeniable. And this competitive advantage springs from the fact that the bank holding company can operate in a manner closed to the independent bank. *Id.* at 6861.
>
> * * * * *
>
> This amendment would require that State legislatures pass specific legislation authorizing bank holding companies from another State to acquire interests in State banks located within its borders. The purpose of this amendment is to return to the States their traditional control over the activities of the State banks now nominally under the State's authority. *Id.* at 6862.

C. The Apparent Exception in 12 U.S.C. §1842(a)(3) Does Not Apply to Interstate Expansion.

The lower court held that the words "other than a bank" in 12 *U.S.C.* §1842(a)(3) concerning asset acquisitions amounts to an exception to the Douglas Amendment. The

lower court cites *State of South Dakota v. National Bank of South Dakota, supra.* However, as previously noted, that case was decided in a different framework. In contrast, the instant action is brought under the Administrative Procedure Act to challenge the decision of the Comptroller in approving the merger in the face of the flat prohibition of the Douglas Amendment.

The issue of the applicability of the Douglas Amendment has previously been before this Court in *First Nat'l Bank in Billings v. First Bank Stock Corporation,* 306 F. 2d 937 (9th Cir. 1962). However, this Court expressed no opinion regarding the dictum of the lower court in that case that the Douglas Amendment was not applicable because of the apparent exception in Section 1842(a)(3).

In determining the intent of Congress from the legislative history, particularly from the debate on the Douglas Amendment set out in Appendix A hereto, this Court has two choices. It may adopt the reasoning of the lower court, or it may give effect to the Douglas Amendment as a bar to any interstate expansion. In the latter case, it would be consistent to hold that the apparent exception in Section 1842(a)(3) applies only to expansion within the state where the operations of the holding company are principally conducted, in this case Minnesota. We urge the Court to resolve any doubt between these alternatives in favor of the latter, in order to give effect to Congressional intent.

The intent of Congress in providing the apparent exception was to prevent a conflict between federal regulatory agencies in their respective jurisdictions in approving bank acquisitions or mergers. For example, a merger between national banks is subject to the approval only of the Comptroller of the Currency (12 *U.S.C.* §§215 and 1828(c)).

It was apparently felt by Congress that an acquisition of assets, to the extent that it constituted a merger between banks where the resulting bank is a national bank, was already covered by another statute (12 *U.S.C.* §215) and that it might be confusing to require approval of the Federal Reserve Board under the Holding Company Act. This might create a situation where one agency might approve and the other disapprove. See Hearings on H.R. 6504 before the House Committee on Banking and Currency, 82d Cong., 2d Sess., at page 24 (1952); Hearings on S. 76 and S. 1118 before the Senate Committee on Banking and Currency, 83d Cong., 1st Sess., at pages 14, 17, 26 and 50 (1953-54).

However, approval of bank mergers under 12 *U.S.C.* §§215 and 1828(c) are matters within the discretionary powers of the three federal regulatory agencies. The Douglas Amendment by its language and its legislative history is intended to be a flat prohibition against interstate expansion, in effect the dropping of a curtain at the state border. It permits of no discretion. Thus, so far as discretion is permitted as to approval of bank mergers, it stops at the state border where a subsidiary bank of a holding company is the resulting bank. This Court can properly make a distinction between intrastate and interstate acquisitions in applying the apparent exception in Section 1842(a)(3). Furthermore, courts are not bound by the literal import of a statute but may apply its manifest intent. As stated in 50 Am. Jur., *Statutes* §240:

> The courts are not always confined to the mere letter of the law, or to the literal or strict meaning of statutory terminology. It often happens that the true intention of the law-making body, though obvious, is not

> expressed by the language employed in a statute when that language is given its literal meaning. In such case, the carrying out of the legislative intention, which is the prime and sole object of all rules of construction, can only be accomplished by departure from the literal interpretation of the language employed. Hence, it is a general rule that the manifest intent of the legislature will prevail over the literal import of the words.

D. The "Consolidation" Was Not an Acquisition of "All or Substantially all of the Assets of a Bank" Within the Meaning of 12 U.S.C. §1842(a)(3).

Assuming arguendo that the Douglas Amendment applies only if an application for approval must be made to the Federal Reserve Board, *Amici* submit that the instant transaction is subject to application procedure.

As set forth previously, Section 1842(a)(3) provides that no application for approval by the Board need be made if a holding company subsidiary bank acquires "all or substantially all of the assets of a bank." However, in this case the consolidation of the intervening banks is far more than a mere acquisition of assets.

Virtually the same situation in a different statutory setting was presented to the United States Supreme Court in *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321 (1963). In that case, the Philadelphia National Bank (PNB) and Girard Trust Corn Exchange Bank agreed to consolidate under the charter of PNB.[2] The United States brought an action to enjoin the proposed merger under the Sherman Act (15 *U.S.C.* §§1, 4) and the Clayton Act (15

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[2]The Supreme Court discussed the difference between a merger and consolidation and noted that for the purposes of its opinion, it would refer to the transaction as a merger. 374 U.S. at 332, n.7.

U.S.C. §§18, 25).[3] The Supreme Court held the Clayton Act had been violated and remanded the case for judgment to be entered enjoining the proposed merger.

Although the antitrust laws were involved in the *Philadelphia* case, much of the Court's reasoning is applicable to an agency action applying the Bank Holding Company Act where a consolidation takes place. In *Philadelphia,* the Court pointed out the Section 7 of the Clayton Act (12 *U.S.C.* § 18) originally applied only to stock acquisitions. However:

> "the courts found mergers to be beyond the reach of §7, even when the merger technique had supplanted stock acquisitions as the prevalent mode of corporate amalgamation. (Citations omitted.) As a result, §7 became largely a dead letter. * * *
>
> "It was against this background that Congress in 1950 amended §7 to include an assets-acquisition provision." 374 U.S. at 338-340.

The Court then discussed the problem of why mergers had not been specifically included and stated:

> "The legislative history is silent on the specific questions why the amendment made no explicit reference to mergers, why assets acquisitions by corporations not subject to FTC [Federal Trade Commission] ju-

[3]"Sestion 1 of the Sherman Act provides in pertinent part: 'Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.' Section 7 of the Clayton Act provides in pertinent part: 'No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly'." 374 U.S. at 323, n.1.

> risdiction were not includ^d, and what these omissions signify. Nevertheless, the basic congressional design clearly emerges and from that design the answers to these questions may be inferred. Congress primarily sought to bring mergers within §7 and thereby close what is regarded as a loophole in the section." 374 U.S. at 341.

When Congress enacted the 1950 amendment to include assets acquisitions, it provided that such assets acquisitions applied "only by corporations 'subject to the jurisdiction of the Federal Trade Commission.' " 374 U.S. at 336. The Supreme Court pointed out that the:

> "FTC, under §5 of the Federal Trade Commission Act, has no jurisdiction over banks. (Citation omitted.) *Therefore, if the proposed merger be deemed an assets acquisition, it is not within §7.*" (Emphasis added.) 374 U.S. at 336.

The Court found that a merger[4] did not come specifically within the terms of either a stock or assets acquisition and decided it must therefore determine the intent of Congress

[4]"A merger necessarily involves the complete disappearance of one of the merging corporations. A sale of assets, on the other hand, may involve no more than a substitution of cash for some part of the selling company's properties, with no change in corporate structure and no change in stockholder interests. Shareholders of merging corporations surrender their interests in those corporations in exchange for their very different rights in the resulting corporation. In an asset acquisition, however, the shareholders of the selling corporation obtain no interest in the purchasing corporation and retain no interest in the assets transferred. In a merger, unlike an asset acquisition, the resulting firm automatically acquires all the rights, powers, franchises, liabilities, and fiduciary rights and obligations of the merging firms. In a merger, but not in an asset acquisition, there is the likelihood of a continuity of management and other personnel. Finally, a merger, like a stock acquisition, necessarily involves the acquisition by one corporation of an immediate voice in the management of the business of another corporation; no voice in the decisions of another corporation is acquired by purchase of some part of its assets." 374 U.S. at 336, n. 13.

to see if Section 7 of the Clayton Act applied to bank mergers. After reviewing various factors, the Court concluded that:

> "the stock-acquisition and assets-acquisition provisions, *read together,* reach mergers, which fit neither category perfectly but lie somewhere between the two ends of the spectrum. * * * So construed, the specific exception for acquiring corporations not subject to FTC's jurisdiction excludes from the coverage of §7 only assets acquisitions by such corporations when not accomplished by merger." 374 U.S. at 342.

Amici submit that the foregoing language controls the consolidation in the present case. Like the Clayton Act, the Bank Holding Company Act has a provision for acquisition of stock (12 *U.S.C.* §1842(a)(2)). If applicable, the transaction is prohibited by Section 1842(d). Again, like Clayton, the Bank Holding Company Act has a provision for acquisition of assets (12 *U.S.C.* §1842(a)(3)). Just as in Clayton (since banks were not subject to the jurisdiction of the FTC), assets acquisitions are beyond the reach of the Board because of the exception provided in Section 1842(a)(3).

The matter to be determined, as in the *Philadelphia* case, is whether Congress intended assets acquisitions by a bank holding company subsidiary bank to include mergers and consolidations. *Amici* submit that the language of the Act itself shows that mergers and consolidations were not intended to come within the meaning of acquiring "all or substantially all of the assets of a bank."

The language of Section 1842 shows that Congress intended to distinguish between an "acquisition of stock," an "acquisition of assets" and a "merger." In Section 1842

(a)(2), the words "acquire direct or indirect control of any voting shares" are used, in Section 1842(a)(3), the words "acquire all or substantially all of the assets" are used, and in Section 1842(a)(4), the words "merge or consolidate" are used. Thus, in three consecutive clauses, Congress distinguished between an "acquisition of stock," an "acquisition of assets" and a "merger." An acquisition of stock may be part of a merger, an acquisition of assets may be part of a merger, but a merger is neither of these standing alone.

In this connection, certain rules of statutory construction are applicable also.

> In the absence of a legislative intent to the contrary, legal terms in a statute are presumed to have been used in their legal sense. 2 Sutherland, *Statutory Construction* §4919.
>
> The use by the legislature of certain language in one instance and wholly different language in the other indicates that different results were intended, and the courts have even so presumed. Under this rule, where language is used in one section of a statute different from that used in other sections of the same chapter, it is to be presumed that the language is used with a different intent. Accordingly, the presence of a provision is one section of a statute and its absence from another are an argument against reading it as implied by the section from which it is omitted. 50 Am. Jur., *Statutes* §274.

The mergers, reorganizations, exchanges of stock, purchase of assets, assumption of all debts and liabilities of the merging banks, and conversion of one to a branch far exceeded the scope of clause (3) which at most permits only acquisition of assets of a bank by a subsidi-

ary bank. Even the appellees have characterized the transaction as a consolidation and not as an "acquisition of assets."

Thus, to paraphrase the Supreme Court in the *Philadelphia* case:

> "So construed, the specific exception [of §1842(a)(3)] for acquiring corporations not subject to the [Federal Reserve Board's] jurisdiction * * * [includes] only assets acquisitions by such corporations when not accomplished by merger." 347 U.S. at 342.

Where a foreign bank holding company expands across state lines by having one of its subsidiaries consolidate or merge with another bank, *Amici* submit that such a transaction must be submitted to the Federal Reserve Board since Sections 1842(a)(2) and 1842(a)(3), *read together*, reach mergers and consolidations. In the absence of a state statute within the terms of Section 1842(d), the Board must deny the application pursuant to Section 1842(d).

The mere fact that the Board does not feel a consolidation comes within its jurisdiction under the Bank Holding Company Act does not foreclose such a construction.[5] The Douglas Amendment, like the 1950 amendment to the Clayton Act, was designed to close a loophole and the intent of Congress to prohibit expansion of foreign bank holding companies in the absence of express state statutory authority should be given effect.

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[5] "Of course, our construction of the amended §7 is not foreclosed because, after the passage of the amendment, some members of Congress, and for a time the Justice Department, voiced the view that bank mergers were still beyond the reach of the section." *United States v. Philadelphia Nat'l Bank, supra,* 347 U.S. at 348.

III.

THE COURT MAY CONSIDER THE PRACTICAL EFFECTS OF ITS DECISION.

The Court has the inherent power to consider the practical effects of its decision in this case. The *Amici* associations see a great potential danger of holding companies rapidly expanding across state lines if the Court approves the device used in this case, and urge the Court to consider the effects of affirming the lower court.

This device is aided by tax benefits under the Internal Revenue Code. The holding company, whose stock is traded on the market and has an ascertainable value, is used to make an acquisition by a tax-free exchange, a benefit extremely attractive to the seller. Once the acquisition is made, the holding company can syphon off the profits earned by the subsidiary 85% tax-free, a benefit attractive to its stockholders. A holding company thus motivated can easily amass more resources because the transaction requires no new cash capital, only stock certificates.

The combination of the device in the instant case, together with these tax benefits, furnish the means and incentives for rapid expansion of holding companies across state lines. Already, Minnesota-based companies control a substantial amount of commercial bank deposits within the state of Montana. Should the Court approve this device, the *Amici* Associations anticipate that holding companies will continue to increase in size and power while independent unit banks will be removed from competition.

The criteria for approval of bank mergers found in 12 *U.S.C.* §1828(c) render that statute an inadequate alternative to controlling this type of interstate expansion. The

1966 amendments to this section incorporate the standards of the Sherman and Clayton Acts, *supra,* at n. 3. These standards require first the delineation of a relevant market area and a determination of whether the control of bank deposits is beyond tolerable limits within that area. As seen in this case, the Butte and Anaconda banks are probably not in the same competitive area. However, if a holding company using the device in this case could, by tax-free stock exchanges, acquire additional, stratetically-located banks throughout the state of Montana, it could effectively lessen competition. This is so because smaller unit banks surrounding a larger bank become, in effect, its satellites.

Smaller country banks tend to use the larger county-seat banks as a correspondent bank. They use the larger bank for deposit of cash reserves, in return for which the larger bank renders many services to the smaller banks, including loan participations, clearance of checks, bond advice, trust services, credit advice and many other services.

The accumulation of reserve accounts in the larger correspondent banks, in turn, are deposited in large city banks in exchange for similar types of services. When the county-seat banks and the larger city banks are owned by a holding company, this funneling process gives dominant power to the entire holding company system. Thus, holding company systems which are able to handle the smallest to the largest of accounts, and to handle all of the needed services for these accounts, present formidable competition to independent unit banks, especially for commercial accounts.

Acquisitions by holding companies not only have an adverse effect on banking competition, but upon the economy in the area of their operations as well. If all the banks

in a community are owned by one holding company, a commercial borrower has one source of credit. If two holding companies own all the banks, he has only two alternate sources, even though there may be a dozen banks in the community.

In a Congressional study published December 23, 1960, it is stated:

> "Therefore, all things being equal, any reduction in the number of banks in a given market area or any feature of concentration such as *the growth of branch banking systems or holding company systems will tend to diminish competition in that area* and make it more difficult for a given businessman to secure loans * * *. It is obvious, then, that in the banking market the existence of alternative sources of supply for the would-be borrower is of the utmost importance." (Emphasis added.)
>
> See "*Banking Concentration and Small Business*", December 23, 1960, a report of the Select Committee on small business, House of Representatives. Eighty-sixth Congress, pp. 6, 78, 82, 90.

Small and medium-sized businesses are dependent upon local commercial banks for their financing because their reputation and credit standing are local. It would be difficult, if not impossible, for these businesses to obtain financing in another locality.

The national policy favors competition in banking, not only because it provides alternate sources of credit and services at fair rates, but also because it permits competition at the correspondent bank level. Where unit banking is prevalent, large city banks compete with each other for the business of smaller banks. Thus, the smaller banks have al-

ternate sources for loan participations and services which they are not equipped to handle. In short, the ideal situation exists where unit banks compete for the business of individual customers and correspondent banks compete for the business of local banks. This two-level competition in banking assures the public of availability of credit and other services at competitive cost.

The *Amici* associations feel that the Court should consider the practical effects of its decision in light of the realities of the banking market in Montana and elsewhere, as well as the avowed intent of Congress in enacting the Douglas Amendment to the Bank Holding Company Act.

CONCLUSION

The *Amici* associations urge this Court to reverse the decision of the lower court and remand the case for the purpose of placing the intervening banks in their status quo before the merger.

Respectfully submitted,

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CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

By, ____________________

HORACE R. HANSEN

APPENDIX A

102 Cong. Rec. 6857-6864 (1956)

The PRESIDING OFFICER. The amendment offered by the Senator from Illinois for himself and other Senators will be stated.

The LEGISLATIVE CLERK On page 8, between lines 6 and 7, it is proposed to insert the following new subsection:

(d) Notwithstanding any other provision of this section, no application shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which such bank holding company maintains its principal office and place of business or in which it conducts its principal operations unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication.

Mr. DOUGLAS. Mr. President, the pending bill, and the amendment which has just been read, are in the true American tradition, for what the sponsors of the amendment are seeking to do is to prevent an undue concentration of banking and financial power, and instead to keep the private control of credit diffused as much as possible. For we know that when the credit resources of a country become concentrated and fall into a few hands, then the industry and trade of that country also become concentrated.

Big banks commonly find it much easier and more to their liking to do business with big business rather than with little business.

JACKSON FOUGHT CENTRALIZATION OF BANKING AND CREDIT

Andrew Jackson realized all this when he faced Nicholas Biddle and the Second Bank of the United States. Biddle, building on the traditions of Hamilton, and supported by the Whigs under Webster and Clay, was attempting to make his bank the dominant financial institution of the whole country. He was fast succeeding in this attempt when Andrew Jackson took him on. Jackson not only opposed the private creation of monetary purchasing power by the bank, but also its tendency toward monopolizing credit by driving out the small banks. He wanted credit and banking to be decentralized and diffused so that men might be free.

In that terrific struggle, lasting over a decade, Jackson, aided by Thomas H. Benton, saved economic democracy in this country for a time by denying a new charter to Biddle's bank. And although the Whigs tried hard to revive Biddle's power, they were turned back by the Democrats and by John Tyler at a later date.

Similarly, when Salmon P. Chase created the national banking system during the Civil War, he not only desired to create a market for Government bonds by building up a supplementary currency built upon them, but he also wanted to have so many national banks created by the lure of double interest that the new banking system would also be diffused like that of the various State systems.

In short, we who are struggling to prevent the concen-

tration of financial power from becoming greater are carrying on the fighting tradition of Andrew Jackson who wanted a competitive and a free America, and not one dominated by a relatively small group of financiers and industrialists.

DANGERS OF CONCENTRATED BANKING POWER SHOWN IN EXPERIENCE OF BRITAIN

If we look abroad we see plenty of corroboration for our fears about the concentration of banking powers. A century and a quarter ago, England had large numbers of provincial bankers who helped to finance the relatively small industries of their localities. But gradually these private bankers were bought up by and merged with the bigger houses, so that for many years now there have been virtually only five banks which have mattered in England and Wales, namely, Barclays, Lloyds, Midland, Westminster, and National Provincial. These firms do more than three quarters of the banking business of the entire United Kingdom, including Scotland and Northern Ireland.

Along with this concentration in banking, and partially caused by it, there has developed a concentration in manufacturing and in industry. There is but 1 chemical company in Great Britain, 2 flour concerns, 2 chocolate and cocoa companies, only a handful of breweries and distilleries, not more than 2 tobacco companies, and tight cartels in steel, tin, machinery, and textiles. Professor Ben Lewis has shown how widespread this stifling of competition is in Great Britain. The Big Five have been important factors in promoting this concentration and in reducing competition.

BANKING CONCENTRATION IN CANADA AND GERMANY ALSO LEAD TO INDUSTRIAL MONOPOLY AND CARTELS

Canada, our neighbor to the north, is going through a similar experience. There are only 11 banks in all of Canada to serve 16 million people. The Bank of Montreal, for example, has absorbed at least 10 other banks and has 603 branches. The Royal Bank of Canada, a consolidation of another 10 banks, has 793 branches. Ten more banks have been absorbed into the Canadian Bank of Commerce, which now has 651 branches, while still another score of banks have been swallowed up in the Canadian Bank of Commerce. The Bank of Nova Scotia, a consolidation of half a dozen banks, has 415 branches, while 2 banks designed to serve primarily the French-Canadian population have 560 and 349 branches, respectively.

The two biggest banks in Canada, namely, the Bank of Montreal and the Royal Bank of Canada, have almost precisely half of the total bank deposits in the entire country. If we add the third largest bank, 67 percent or two-thirds of the countrywide total will be included. The top four have well over three-quarters of the total deposits.

As in Great Britain, monopoly and quasi-monopoly in industry have accompanied this concentration of banking. There is, I believe, only one tobacco company, for example, in all of Canada, and one private railroad; and a similar situation exists in a very large number of industries. Moreover, industry and banking are so intertwined in directing personnel and in financing as to prove how the concentration of banking power has helped to promote industrial monopoly and quasi-monopoly.

Incidentally, the power of the private monopolies led to the movement for nationalization which was carried out for about one fifth of the British industry by the Labor Party from 1945 to 1951.

The example of Germany is notorious. Prior to Hitler there were only three banks in Germany, namely, the Deutsche, the Dresdner, and the Commerz Banks. These played ball with and helped the cartels and monopolies. As all students of nazism know, it was the cartels and the big banks which financed Hitler's final drive to power. Thus, concentration of financial power helped on the concentration of economic power, and then the two forces joined hands to aid in creating a dictatorship of political power with all of the terrible consequences which ensued.

CONCENTRATIONS IN BANKING AND CREDIT ARE ALSO SERIOUS DANGERS IN THIS COUNTRY

All these examples paint an image of what is likely to happen in this country if we permit the concentration of banking and credit, which has already gone far, to go farther. For here, as elsewhere, the control over credit is moving into fewer and fewer hands.

At the same time, industry has been moving out of competition into closer and closer concentration—monopoly and quasi-monopoly. This has been helped by the big banks. If we do not wish to travel the path of Canada, Great Britain, and Germany, we should do something effective to check and, if possible, to roll back the concentration of banking and credit. For he who controls the credit of a country controls the industry of that country and, ultimately, the political life of the Nation as well.

Unfortunately, we have already traveled very far down the way of the concentration of credit and banking. This has been done by the growth of the original home offices of the big banks, such as the Continental and First National Banks of Chicago and the Chase and National City Banks of New York, but also by three other forms of accretion, namely, mergers, branch banking, and bank holding companies.

BANK MERGERS HAVE INCREASED RAPIDLY

During the past 9 years, bank mergers have been growing apace. The following number of banks have been merged since 1947:

Year:	*Number of mergers*
1947	82
1948	77
1949	76
1950	89
1951	79
1952	99
1953	115
1954	207
1955	231
Total	1,076

Source: Federal Deposit Insurance Corporation.

6858

Thus, nearly 1,100 banks merged during these 9 years, with the numbers greatly increasing during the last 3 years. This, moreover, was during a period when the total num-

ber of banks in the country was decreasing by 475, from 14,759 to 14,284. This was a decrease of 3.2 percent.

Among the big mergers were those in New York City of the Chase National Bank and the Bank of Manhattan, of the National City and the First National, the Chemical Bank & Trust and the Corn Exchange, and the Bankers Trust and Public National. These mergers alone involved \$19½ billion of assets and over 57 percent of the banking facilities of New York City. There have been a great many other mergers in other portions of the country.

BANK BRANCHES HAVE ALSO MULTIPLIED

The second way control over credit becomes concentrated is through the opening of branches. The organization of branch banks proceeded very rapidly in the 1920's, and to check their growth various States passed laws limiting, and in some cases preventing it, as in the case of Illinois. National banks had previously been implicitly prohibited from opening branches, and there was a strong movement to remove this prohibition and completely open up the field for the national banks. This, however, was not done. Instead, by the McFadden Act and other measures, national banks have been permitted to open branches only to the degree permitted by State laws and State authorities.

I may say that what our amendment aims to do is to carry over into the field of holding companies the same provisions which already apply for branch banking under the McFadden Act—namely, our amendment will permit out-of-State holding companies to acquire banks in other States only to the degree that State laws expressly permit them; and that is the provision of the McFadden Act.

Despite these restrictions on branch banking there has been a great expansion of branches during the last 9 years. At the end of 1946 there were 4,220 branches. This number had increased by the end of last year to 7,391. This was a growth of 3,171 branches, or 75 percent. Among the banks with many branches is the Bank of America, which is now the largest bank in the world, and which dominates banking in California.

HOLDING COMPANIES HAVE ALSO EXPANDED RAPIDLY

The third way in which credit is becoming concentrated is through the device of holding companies. Holding companies have been developed in part—I would say largely—in order to get around restrictions on branch banking. A State will prohibit branch banking, and so a holding company will be organized, which will buy up individual banks and operate them, in effect, within the State, and which sometimes buy up banks in other States and also operate them, in effect, as branches. Even though local officers and directors are used, the direction rests in the holding company. Two out-of-State holding companies have invaded Illinois in just this way, and each company controls three banks in Illinois, despite our Illinois laws prohibiting branch banking.

Now, the two holding companies which operate out of Minneapolis—namely, the First Bank Stock Corporation of Minneapolis, which had 75 banks and 6 branches, and which operated in 4 States, with total deposits of $1,352,-000,000 as of the end of 1954, and the Northwest Bancorporation of Minneapolis, which had 72 banks and 22 branches in 7 States with deposits of $1,583,000.000—have

been developed and formed largely because of restrictions on branch banking in Minnesota, Nebraska, North Dakota, South Dakota, and Montana. Since branch banking was prohibited or restricted, at least originally, these holding companies buy up the controlling interests in the banks and operate them as branches.

I see the eminent senior Senator from North Dakota present, and if he wishes, he may make whatever comment he wishes to make,

Mr. LANGER. I have no comment except to say that what the distinguished Senator has said is absolutely true.

Mr. DOUGLAS. I thank the Senator.

In New York the State is divided into 10 zones. Branch banking is permitted within each of the zones, but a bank cannot have branches in another zone. What happened there? The Marine Midland Co., of Jersey City, was organized, and it bought banks in each of the 10 zones and established 125 branches. As of the end of 1954, it had total deposits of $1,635,000,000. Now, the letter of the law is complied with, but, in effect, each of those 10 banks—each one within a given zone—is operated as a unit of a centralized banking system.

TRANSAMERICA CORP. IS LARGEST HOLDING COMPANY AND GROWING RAPIDLY

The biggest holding company is, of course, Transamerica, which was originally closely affiliated with the Giannini banking interests and the Bank of America, but which has attained greater independence in recent years.

As the eminent junior Senator from Virginia stated

yesterday, that holding company not only had banks in 5 States, with 167 branches, and banking deposits of $2,021,-000,000 as of the end of 1954, but it is somewhat unique in that it has a large number of nonbanking corporations which it controls and directs.

I wish to make a correction for the Record. I said that at the end of 1954 Transamerica had banks in five States. As I shall show in a few minutes, it now has banks in 10 States, because it has been expanding, in recent months and weeks, at a very rapid rate.

I yield to the Senator from Virginia, who seems to want to make a statement.

Mr. ROBERTSON. I was going to suggest what the Senator has just stated, that Transamerica now has banks in 10 States.

Mr. DOUGLAS. That is correct. Perhaps we should say that "Eastward the course of banking empire takes its way."

In addition, Transamerica owns one of the largest insurance companies in the United States—the Occidental Life Insurance Co.—and other insurance companies and a variety of other industrial enterprises, including a salmon packing company which packs some of the good Columbia River salmon, which I am sorry to say have displaced Maine salmon from the table, and so forth. As everyone should know, the present bill requires the divestiture of those nonbanking assets.

Mr. MORSE. Mr. President, will the Senator from Illinois yield?

The PRESIDING OFFICER (Mr. Neuberger in the

chair). Does the Senator from Illinois yield to the Senator from Oregon?

Mr. DOUGLAS. I am glad to yield.

Mr. MORSE. I regret that the Senator from Illinois has said he is sorry that Columbia salmon have displaced Maine salmon. I will see that he gets a Columbia salmon again, to refresh his taste and enable him better to understand why Columbia salmon have replaced Maine salmon.

Mr. DOUGLAS. The Senator from Illinois was permitting his boyhood fondness for landlocked Maine salmon to express itself, in contrast with the sockeye salmon which goes through such an amazing odyssey from the inland lakes to the sea, and back again.

Mr. President, not only does Transamerica have branches in California, but it also has greatly expanded its operations elsewhere. It has purchased a bank in Oregon—the First National Bank, I believe—and has expanded its holdings there until they totaled 68 branches and had 45 percent of the bank deposits in that State at the end of 1954. It controls most of the banking resources in Nevada. The two banks it controls in Nevada had 77 percent of the bank deposits in that State at the end of 1954. At the end of 1954, the 1 bank it owned in Arizona had 17 branches and 21 percent of the bank deposits in that State; and since that time there has been further expansion. So, Mr. President, the Transamerica Corporation is a most powerful group.

OTHER HOLDING COMPANIES CONTROL LARGE PERCENTAGE OF TOTAL DEPOSITS IN VARIOUS STATES

Now let us consider the two holding companies which operate out of Minneapolis: The First Bank Stock Corp., with deposits at the end of 1954 of $1,352,000,000; and the Northwest Bancorporation, with deposits of $1,502,000,000. If we add them together, we find that those 2 holding companies then controlled 55 percent of the bank deposits in Minnesota, 44 percent of the bank deposits in Montana, 29 percent of the bank deposits in North Dakota, and 32½ percent of the bank deposits in South Dakota; and these figures are correct only as of the end of 1954.

In a minute I shall speak of the extraordinary expansion which has occurred in more recent years. The figures I have given are taken from pages 51 and 52 of the printed hearings of the Banking and Currency Committee which are on the desks of all Senators. In addition, there are minor holdings of the Northwest Bancorporation in Iowa, Nebraska, and Wisconsin.

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Then there is the First Security Corp., which is based primarily upon Utah, where in 1954 it controlled almost 24.6 percent of the bank deposits in that State; and 32.5 percent of the bank deposits in Idaho. In recent years this corporation has also been expanded.

As is well known, the corporation is controlled by the Eccles family. Mr. Eccles was for many years a member of the board of governors of the Federal Reserve System, and for many years was chairman of the board. In my opinion he was one of the most distinguished public serv-

ants we have had in the United States for many years. Mr. Eccles made war on holding companies when he was a public servant, and I know he was absolutely sincere in doing so, because he thought they were against the public interest. Then he resigned from the Federal Reserve Board, and went into private banking; and now as a private banker he is naturally seeking to expand his banking interests to the fullest degree possible. There is nothing in the slightest degree unethical in what Mr. Eccles is doing. He happens to be a close personal friend of mine. But since I believe that the expansion of bank holding companies is not in the public interest, I shall oppose the future expansion of the First Security Corp., across State lines, just as I am opposing expansion of other bank holding corporations.

Mr. President, in addition to those instances, there are also a considerable number of bank holding companies which at present operate only within State lines, whereas the ones to which I have previously referred operate across State lines. However, there are some which operate only within a single State. As I have previously mentioned, one of them is the Marine Midland Corp., operating in New York, with deposits at the end of 1954 of $1,636,000,000. Another is the Wisconsin Bankshares Corp., which had 6 banks and 14 branches, and at the end of 1954 had deposits of $780,000,000.

Still another is the BancOhio Corp., with 21 banks and 17 branches, and deposits of $556,000,000 at the end of 1954. In Massachusetts there are 2, namely, the Baystate Corp., with 9 banks and 66 branches and with deposits of $399,000.000; and the Shawmut group, with 14 banks, 37 branches, and deposits of $523,000,000.

Then there are two, which have just been given special exemption, namely, the Trust Company of Georgia Associates and the Trustees of the First National Bank of Louisville, of Louisville, Ky.

Then there are minor holding companies as well.

Mr. KUCHEL. Mr. President, will the Senator from Illinois yield to me?

Mr. DOUGLAS. I am glad to yield for a question.

Mr. KUCHEL. First of all, let me ask the Senator from Illinois whether he is now arguing, or laying a foundation, for the amendment he has proposed.

Mr. DOUGLAS. That is correct.

Mr. KUCHEL. I wish to say to the Senator from Illinois that my inclination is to support his amendment. But I wish to ask a question. I think the Senator from Illinois said a few moments ago that in his judgment the theory of holding companies was contrary to the public interest.

Mr. DOUGLAS. No; I said that further expansion of holding companies in the field of banking would be contrary to the public interest.

Mr. KUCHEL. Then do I correctly understand that it is the position of the Senator from Illinois that the situation existing today with respect to bank holding companies in his judgment is not against the public interest?

Mr. DOUGLAS. If any other Senator wishes to make a motion to require bank holding companies to divest themselves of their bank stock as well as of their nonbanking assets, the Senator from Illinois will support such a motion.

But all that the Senator from Illinois is at present trying to do is to prevent bank holding companies from expanding across State lines, unless the States give them explicit permission to do so.

Mr. KUCHEL. As I say, my inclination is to support my friend from Illinois in that venture.

Mr. DOUGLAS. The inclinations of the Senator from California are always very helpful and generous.

Mr. KUCHEL. I appreciate that statement.

If the pending bill is designed to prohibit holding companies in the public interest, my question of the Senator is this—and I asked the same question earlier of the Senator from Indiana [Mr. Capehart]—Why does the bill make certain specific exemptions, on the basis of policy?

Mr. DOUGLAS. The Senator from Illinois is not too happy about the exemptions which we have granted.

Mr. KUCHEL. Is his unhappiness of sufficient strength to cause him to oppose the bill on that basis?

Mr. DOUGLAS. No; it is not, because I think, on the whole, the bill is a step forward. I am not too happy about these exemptions. They came about in the play of stresses and strains of banking and political life. I think I voted against most of them in committee. But if my amendment is approved, I think, on the whole, the bill will be a big step forward. If it is not approved, it will be a little step forward.

Mr. KUCHEL. As I understand, the Senator cannot find justification for eliminating some holding companies, while at the same time permitting and protecting others.

Mr. DOUGLAS. The Senator from Illinois has been very unhappy about that situation.

HOLDING COMPANIES HAVE EXPANDED MORE RAPIDLY IN RECENT MONTHS

Mr. President, the figures which I have been giving apply as of the end of 1954. Since then the process of acquisition of banks by holding companies has proceeded apace.

The First Security Corporation has been "getting into the act." It bought up the Commercial Bank of Utah, with $18 million in deposits, and 8 banking offices, in January of this year, and the Uinta State Bank, of Vernal, Utah, according to a report in the American Banker for March 12, 1956.

Transamerica has been extending its empire. It acquired the Southern Arizona Bank & Trust Co., with 7 banking offices and $77 million in deposits, in November of 1955. I believe that is the old group of banks formerly headed by Lewis W. Douglas.

It acquired the Bank of New Mexico, with $23 million in deposits and 4 banking offices, in January 1956.

It took over the First National Bank of Caldwell, Idaho, the Continental State Bank at Boise, Idaho, and the Bank of Eastern Idaho, at Idaho Falls, with $41 million in total deposits and 7 banking offices, in January 1956. It took over the Walker Bank & Trust Co. of Salt Lake City, with $117 million in deposits and 5 banking offices, in February 1956.

It took over the Sandy City Bank of Sandy, Utah, with $7 million deposits and 2 banking offices, in March 1956.

I hold in my hand an article from the Salt Lake Tribune of April 13, 1956, which describes the purchase by Transamerica of the Casper, Wyo , First National Bank and the Riverton National Bank, which were old-time Wyoming financial institutions. The Waddell family of Casper were the principal shareholders in those institutions.

According to my information, Transamerica has also purchased in March 1956 the Cache Valley Banking Co., of Logan, Utah, with $9 million in deposits. These three Utah acquisitions by Transamerica give it and the First Security Corp. together 49½ percent of the bank deposits in that State, according to data furnished to me today by the Federal Reserve Board.

If my information is correct, Transamerica also purchased the Montana Bank, of Great Falls, Mont. Since we held the hearings last year, it has gone into New Mexico, Idaho, Utah, Montana, and Wyoming for the first time. The financial information which I am able to obtain is that in the case of many of these banks Transamerica has paid far more than the book value of the stock.

As Transamerica has been expanding, the Minneapolis bank holding companies have been expanding as well. The First Bank Stock Corp of Minneapolis, Minn., has purchased the Worthington National Bank of that town in Minnesota, with $7 million in deposits; the Northern Minnesota National Bank, of Duluth, with $57 million in deposits; the Duluth National Bank, of that city, with $9 million in deposits; the First National Bank of Hibbing, Minn., with $13 million in deposits; the First National Bank of Virginia, Minn., with $12 million in deposits; and the Batavia National Bank, of LaCrosse, Wis., with $12 million

in deposits. This LaCrosse acquisition moves their Minneapolis holding company into Wisconsin for the first time.

Marine Midland of New York has also purchased two banks, namely, the First National Bank of Herkimer, with $9 million in deposits, and the Bank of Towanda, also with $9 million in deposits.

So the bank holding companies have been expanding very rapidly in recent months, possibly because of a desire to "beat the gun" so that they would have a

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foothold in new States and not be required to divest themselves of these banks when the new law went into effect—and possibly in fear that if my amendment were approved they would be shut off from future expansion across State lines.

Mr. President, I have said all this to lay the background for our amendment. It is not merely my amendment. It is also sponsored by a very eminent group of Senators. It has been advocated, as we all know, by the Independent Bankers Association of America. It has been endorsed by the American Bankers Association, although I suspect that some of the big banks are not too happy with it. Nevertheless, the official action of the American Bankers Association is in its favor.

COMMITTEE BILL MAKES NEEDED IMPROVEMENTS

I wish to speak very briefly about the changes which our amendment would make in the bill as it has been reported. I think the Senator from Virginia [Mr. Robertson] deserves to be congratulated for the work he has done in

getting this bank holding bill out on the floor of the Senate. It makes two fundamental changes. In the first place, it requires the divestment by bank holding companies of nonbanking assets, and hence removes the possibility of future abuse.

The second feature is that any future expansion of bank holding companies, including the purchase of additional banks, will be permitted only if the Federal Reserve Board gives its permission.

The bill lays down a number of standards to be followed by the Board, including standards relating to financial history, condition of the company, prospects of the company, character of management, needs of the community, whether the acquisition would expand the size of the bank holding company beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking, and so forth.

PENDING AMENDMENT PREVENTS BANK ACQUISITION BY OUT-OF-STATE HOLDING COMPANY UNLESS STATE LAW EXPRESSLY PERMITS

Our amendment would prohibit bank holding companies from purchasing banks in other state unless such purchases by out-of-State holding companies were specifically permitted by law in such States. At present no State specifically grants such permission. Therefore the immediate practical effect would be to bar the expansion of bank holding companies across State lines. But the amendment would leave the way open for States to make explicit provision for such purchases and acquisitions if they so de-

cided. If they were to do so, then such expansion would be subject to the rules and judgment of the Federal Reserve Board.

Even with my amendment, the Federal Reserve Board would still have final jurisdiction over the acquisition of banks or bank holding companies within a given State, that is, intrastate acquisitions. If and when individual States permitted a bank holding company from another State to acquire assets across State lines, then the Federal Reserve Board would have final jurisdiction in those cases as well.

I wish to repeat that, so far as interstate acquisition of banks is concerned, namely, purchase by bank holding companies of banks in other States, the provision in my amendment is in principle almost identical with the present provision which governs branch banking.

Therefore, it is a logical continuation of the principles of the McFadden Act, which tried to prevent the Federal power from being used to permit national banks to expand across State lines in a way contrary to State policy and, of course, under the McFadden Act, even to expand within a State.

Anyone who favors States rights, it seems to me should support my amendment. I am not urging it on that ground, however. I believe in a somewhat unified banking system. However, so far as the bank holding companies are concerned I want to check their expansion. This seems to me to be about the best way of doing so.

AMENDMENT DOES NOT AID BUT RATHER IMPEDES FURTHER MONOPOLISTIC EXPANSION ACROSS STATE LINES

My good friend the Senator from Virginia [Mr. Robertson] yesterday, in his speech presenting the bill, criticized my amendment on the ground that, by making further interstate expansion more difficult, it would freeze the present situation and would aid monopoly.

In the first place, it does not freeze the situation, as the analysis of the powers left to the Board makes clear. It is still possible to have an expansion of a bank-holding company within its home State, if it musters the approval of the Federal Reserve Board. Moreover, if State law permits, and if approved by the Board, interstate acquisitions are possible. Therefore the amendment does not freeze the situation.

If the amendment aided the existing holding companies, as the Senator's argument implies, they would favor it. They do not favor it. They are a very able group of men. I am informed that Transamerica and the two Minneapolis holding companies, and the First Security Corporation of Utah, are very much opposed to my amendment. I believe they know their own self interest, and pursue it, as is quite proper. I am not blaming them for that. Therefore it must be news to them that the amendment would aid and protect them in their existing position.

Basically, the argument of the Senator from Virginia seems to be that the way to check monopoly is not to check it, and that by permitting other competing banking concentrations the same right to expand and take over independent banks, which is enjoyed by present holding companies, we would bring about a more competitive situation.

Surely the existence of monopolistic conditions in some areas is no justification for true opponents of monopoly to urge that their growth be permitted in all areas, on the principle of "justice among monopolies." The present degree of concentration of control does not give everyone else a vested right to equivalent expansion. Furthermore, the big holding companies, freed from the restraint of my amendment, would undoubtedly keep far ahead of the rest of the pack. These are unequal races, in which the strong usually outdistance the weak.

I am not interested in having a bank situation in which there are only two banks in a State competing with each other. I am interested in a bank situation in which there are a large number of banks with no monopoly and with a dispersion of power.

If the Senate really desires to reverse the trend toward the concentration of banking, it could write legislation requiring the divestiture not merely of nonbanking assets, but of banking properties themselves, beyond certain limits. If anyone proposes an amendment such as that, I again wish to assure him in advance that I shall support it. However, no one suggests such a proposal in the bill, and it should not be argued against my amendment that it does not require it.

What the bill with my amendment does is to check a rising trend to monopoly without undoing it completely.

I yield the floor.

Mr. ROBERTSON. Mr. President, I suggest the absence of a quorum.

Mr. BENNETT. Mr. President, will the Senator withhold the suggestion for the present?

Mr. ROBERTSON. I will withhold it for the moment.

Mr. BENNETT. Mr. President, I have grave doubt about the wisdom of the amendment of the Senator from Illinois [Mr. Douglas] in the form in which it is presented. I recognize that it is less severe than the House language which contains a flat, unequivocal prohibition against bank holding companies crossing State lines. But it is only slightly less severe in that it makes a blanket prohibition which can only be lifted by specific affirmative action by the States and in its present form creates an evil which I must oppose.

The net effect of the amendment is to require every State that does not now have legislation prohibiting bank holding companies to discriminate in favor of such corporations that may be resident in their State and against bank holding companies resident in any other State and requires affirmative legislation to remove the discrimination.

So far as I can learn, no State has of its own volition, and by action of its own legislature, set up such a discrimination. There are some States, including the State of Illinois, which prohibit all bank holding companies, domestic as well as foreign. This is not discriminatory. But I know of no State that permits domestic bank holding companies to operate within its borders and shuts out their counterparts residents in other States. That would be the effect of this amendment.

For Congress to require discrimination in interstate commerce, and then leave it to the several States to correct it, is a strange approach, out of harmony with the basic American concept of fairness and fair play. It smacks a little of the concept that a man is guilty until proved innocent.

It will have two other interesting consequences. It will preserve and protect the status quo in those States in which foreign or domestic bank holding companies are now operating, and will serve to intensify their expansion within these narrowed ranges. This would tend to set up some areas of bank holding company concentration and others that will be free.

I think I can look at this problem objectively. In my State we have two big bank holding companies represented, one foreign and one domestic, and a number of smaller local banking groups. At last count we had 97 banks in the State, 58 in holding companies and 46 operating as independents. So I am in the middle, and can afford to look at the principles involved. Since I want to eliminate rather than create discrimination, and since I want the States left free to act on this subject affirmatively for themselves, and not first be burdened with discrimination by our action, I am forced to vote against the amendment.

Mr. BRICKER. Mr. President, I wish briefly to discuss the amendment offered by the Senator from Illinois [Mr. Douglas], not particularly as it affects the rights of the States, although I did serve for many years in my State in a capacity which afforded me opportunity to consider attempts to prevent discrimination by one State against another, the tendency, manifested again 2 years ago, to Balkanize State jurisdictions, and matters related to constitutionality, and so forth, and I believe constructive service was rendered in that field. However, I consider a constitutional question to be involved in the amendment submitted by the Senator from Illinois.

Mr. President, the amendment proposed by the Senator

from Illinois was considered by the Banking and Currency Committee and was rejected by the committee. In fact, only four votes were recorded in favor of the proposal. The Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation are all opposed to this amendment, because, in effect, it constitutes an absolute prohibition against future expansion by bank holding companies. I am sure it is obvious that every bank holding company in the country is opposed to this punitive proposal.

I stated earlier the procedure under S. 2577 for the Federal Reserve to consider every proposed acquisition of additional banks whether within the State or across State lines. Both types of acquisitions are treated the same. Under the bill, a bank holding company must obtain prior approval from the Federal Reserve Board before it can acquire a bank. The Federal Reserve Board in considering an application for an acquisition must take into consideration five factors. These factors are, first, the financial history and condition of the company or companies in the banks concerned; second, their prospects; third, character of their management; fourth, convenience, needs, and welfare of the communities in the area concerned; and, fifth, whether or not the effect of such acquisition would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking.

The last factor I named is the most important and requires the Federal Reserve Board to consider the question of the public interest and the preservation of competition in the field of banking. This provision gives the Fed-

eral Reserve Board power to prevent undue concentrations of banking activities and at the same time permits the strengthening and expansion of banking facilities when needed.

The Douglas amendment prohibits the acquisition of a bank outside the home State of a bank holding company unless the laws of the State to be entered specifically authorize such acquisition. I submit, Mr. President, that no State in this country has enacted laws along this line. So the effect of the Douglas amendment is to absolutely prohibit a bank from crossing State lines. This proposal suggests that bank holding companies are evil per se and that any further growth should be prohibited. The amendment is another attempt to force bank holding companies out of business. This is contrary to the theory of the Senate bill which seeks to regulate bank holding companies and not to punish them.

Some statements have been made to the effect that this amendment protects States' rights. I believe that I am as strong a States rights advocate as any Member of this body. However, this amendment forces States to take legislative action to protect themselves and thus is clearly a derogation of States rights.

Section 7 of S. 2577 preserves the true States rights in regard to this question. The bill reserves to the States their present authority to regulate bank holding company operations within their borders and does not force the States to take any action. The committee believes that this provision is an adequate preservation of the rights of our States.

I should also like to point out that the Douglas amendment runs counter to the policy of the National Bank Act

and our dual system of National and State banks. The National Bank Act recognizes the exclusive jurisdiction of the Federal Government over national banks just as the States have exclusive jurisdiction over State banks. The branch banking law is cited as a precedent for giving powers to States over national banks. The branch-banking law is the only major exception to the general rule that the Federal Government has exclusive jurisdiction over national banks.

However, it must be remembered that prior to the McFadden Act of 1927, national banks did not have statutory authority to establish branches. The purpose of the McFadden Act and the Banking Act of 1933 was to permit national banks to compete with State banks in States which authorized State banks to have branches. Congress merely gave national banks equal powers with State banks in respect to branch offices. These acts enlarged the powers of national banks rather than restricted them. Certainly it cannot be argued successfully that the branch-banking law is a precedent for permitting States to place restrictions on national banks and take away privileges they now enjoy.

In conclusion, Mr. President, I wish to reiterate that the committee rejected this amendment. The Federal Reserve Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and all the bank holding companies are absolutely opposed to it, and I hope the Senate will reject the amendment in the interest of sound banking and the preservation of the competitive system of banking in our country as between the various States and as between the Federal Government and the States.

Mr. PAYNE. Mr. President, I ask unanimous consent to have printed in the Record, a statement concerning the

amendment offered by the Senator from Illinois, for himself and other Senators, and concerning the bill itself.

The PRESIDING OFFICER. Is there objection?

There being no objection, the statement was ordered to be printed in the Record, as follows:

STATEMENT BY SENATOR PAYNE

The junior Senator from Maine would like to speak briefly today in support of bank holding company bill S. 2577, now under debate by the Senate. At the very outset, I would like to emphasize my firm faith in the independent banking system which has been the foundation of economic growth in the United States, the traditional source of capital investment, and the holder of the savings of millions of individual Americans. It is my firm belief that S. 2577 with the amendments approved by the Senate Committee on Banking and Currency and with the additional amendment proposed by the senior Senator from Illinois [Mr. Douglas] will halt the trend toward the destruction of the independent banking system and will preserve independent banking as the financial base of the United States economy.

During the hearings held last summer on various bank holding bills before the Senate Committee on Banking and Currency, of which I am a member, witnesses representing bank holding companies repeatedly questioned the need for regulation or limitation of their operations. These witnesses stated that there had been no abuse of either the letter or the spirit of the law in their operations. And they were right, because there is now no law that effectively regulates the conduct of the bank holding company. The bank holding company is structurally beyond the reach of present

statutory laws. Separate segments of its operations are subject to careful regulation, such as its subsidiary banks which are subject to the national banking laws and to the banking laws of the States in which they operate. The non-banking subsidiaries of bank holding companies are regulated in the same way as other completely independent corporations. However, the totality of the bank holding company operation is in many respects, because of its unique structure, beyond the law. Through its ability to cross State lines, the bank holding company can operate in a way closed to the independent bank. The competition presented by a single bank which is a subsidiary of a bank holding company may not in any legal sense be unfair competition, but the fact that it is backed by the powerful assets of a vast bank holding company gives it a competitive advantage that is undeniable. And this competitive advantage springs from the fact that the bank holding company can operate in a manner closed to the independent bank.

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I have heard it said that the independent banker is afraid of competition. I do not believe that it is necessary to give any extended argument to disprove this assertion. The independent banker is naturally afraid of competition which is going to put him out of business. And he has every right to resent the competition of the bank holding company subsidiary which has capital resources behind it of a vastness not available to the independent banker by the very nature of his operation as an independent bank. Some would say that this kind of competition is good for the independent banks. It is not good for them if it is going to eliminate them as independent banking units. And it is not good for the economic stability of the country if independent banks are no longer able to compete successfully.

It is important to establish in any discussion of bank holding company legislation the value of the independent banking system. The independent banking system has been the traditional banking system in the United States. The independent banks financed the economic growth of this country through some of its most expansive periods. Methods and regulations governing the methods of independent banking have evolved with the development of our economy. Mistakes which were made have been corrected so that we now have a carefully regulated and safe independent banking system, privately owned and operated, working for the benefit of the communities the independent banks serve.

The independent bank is a local operation, owned and managed by citizens of the community in which it operates. The particular financial needs and problems of the community are well known and thoroughly understood by the directors and officers of the local independent bank who in no small measure contributes to the economic growth and financial well-being of that community. What is important to the community is important to the financial leaders of that community. And in the independent bank those financial leaders are in a position to act in the interests of the community.

In the bank whose control is in the hands of the bank holding company's shareholders, the policy of the bank must necessarily be concerned with insuring a profit to the controlling shareholders who are not in all likelihood, local people. What is most profitable for the shareholders may also be in the interest of the community in which the bank is operating, but this does not necessarily follow. Where there is a conflict between community interest

and the profit interest of the shareholders who are not members of that community, it would seem likely that the policy of the bank might well be directed toward serving its shareholders. In the independent bank serving a community this situation will not arise in the same way. True the directors and officers of the independent bank must also serve their shareholders. But in most cases those shareholders are also local people, residents of the community. No one would pretend that every action taken by every board of directors of every independent bank is inevitably in the interests of the community which these banks are serving. But the incidence rate of a correaltion between the interest of local shareholders and the community itself could naturally be expected to be higher in the case of the independent bank than in the case of a bank which is owned by a bank holding company whose shareholders are spread throughout a far wider area than the town or city.

The bank is a semipublic institution. The bank may be privately owned, but in serving its owners, its activities must be in accord with the public interest, both to justify its existence and to comply with the laws which regulate banking. By insuring the preservation of the independent banking system through the passage of S. 2577, we can insure the preservation of the public character of banking.

The divestment provisions of S. 2577 have been described by some as unduly harsh, unnecessary, and unjust. If we accept the fundamental argument, and I think we must accept it, that it is neither wise nor safe nor in the public interest to combine banking assets with nonbanking assets in the same financial structure, then the divest-

ment provisions of S. 2577 are neither unduly harsh, unnecessary, nor unjust. Special tax exemptions in the act will enable bank holding companies to preserve their nonbanking assets after divestment in the form of banking assets, or the bank holding company may distribute them to the holding company shareholders as the directors see fit.

Although I approve of S. 2577 as a definite step in the right direction, it is my feeling that more can be done to insure the preservation of the independent banking system at this time. My distinguished colleague, the senior Senator from Illinois [Mr. Douglas] has introduced an amendment to S. 2577 which I have cosponsored. This amendment would require that State legislatures pass specific legislation authorizing bank holding companies from another State to acquire interests in State banks located within its borders. The purpose of this amendment is to return to the States their traditional control over the activities of the State banks now nominally under the State's authority.

S. 2577 leaves the control of the future expansion of bank holding companies to the discretion of the Federal Reserve Board. It is not my intention to question the capacity of the Federal Reserve Board to carry out the will of the Congress, but it seems to me that the control of expansion of bank holding companies across State lines into State banks is a matter of primary concern to the State governments and is an area best left to their discretion rather than to have it solely under the jurisdiction of the Federal Reserve Board.

Mr. President, in this brief statement, I have not attempted to go into the complexities of S. 2577. I have spoken in very broad terms, and have tried only to outline some

of the reasons why I am in favor of S. 2577 with the amendment proposed by Senator Douglas. We now have before us a bill which is just and reasonable. It does not pretend to rectify all the problems involved in bank holding companies. But it will, if enacted, go a long way toward halting the trend toward overconcentration of financial interests in the United States. The Douglas amendment would reestablish State authority over State banks. I am convinced that it will be in the interests of our banking system and in the interests of all the people of this Nation to enact S. 2577 with the Douglas amendment.

Mr. ROBERTSON. Mr. President, I suggest the absence of a quorum.

Mr. MORSE. Mr. President, will the Senator from Virginia withhold his suggestion?

Mr. ROBERTSON. I shall be glad to do so.

Mr. MORSE. Mr. President, I wish to associate myself with the remarks of the Senator from Illinois [Mr. Douglas]. I have been advised that his amendment is favored by independent bankers across the country. I know of no group which is more identified with free enterprise than are the independent bankers; and I know of no group more in favor of States rights, so far as concerns protecting the economic interests at the lower level of private business institutions. What they have in effect pointed out is that the breadth of the extension of great banking empires across State lines as having a very detrimental effect upon the continuation of the American competitive system in the banking industry. It seems to me that if we are in favor of the competitive enterprise system we will support the Douglas amendment.

Mr. ROBERTSON. Mr. President, I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk called the roll, and the following Senators answered to their names:

Aiken
Anderson
Barkley
Beall
Bennett
Bible
Bricker
Bridges
Butler
Byrd
Capehart
Carlson
Case, N. J.
Case, S. Dak.
Cotton
Curtis
Daniel
Dirksen
Douglas
Duff
Eastland
Ellender
Ervin
Frear
Fulbright
George
Green
Hayden
Hennings
Hill
Holland
Hruska
Humphrey
Jackson
Jenner
Johnson, Tex.
Johnston, S. C.
Kefauver
Kerr
Knowland
Kuchel
Laird
Langer
Lehman
Long
Magnuson
Malone
Mansfield
Martin, Iowa
Martin, Pa.
McCarthy
McClellan
McNamara
Millikin
Morse
Mundt
Murray
Neely
Neuberger
Pastore
Payne
Potter
Purtell
Robertson
Russell
Schoeppel
Scott
Smathers
Smith, Maine
Smith, N. J.
Symington
Thye
Welker
Williams
Wofford
Young

The PRESIDING OFFICER. A quorum is present.

The question is on agreeing to the amendment offered by the Senator from Illinois [Mr. Douglas] on behalf of himself and other Senators.

Mr. ROBERTSON. Mr. President, I ask for the yeas and nays on the Douglas amendment.

The yeas and nays were ordered.

Mr. KNOWLAND. Mr. President, for the information of the Senate will the distinguished Senator from Virginia, who is handling the bill on the floor, indicate what position the Federal Reserve Board and the FDIC took, if they took any position on the matter, when the amendment was presented in committee?

Mr. ROBERTSON. Mr. President, the amendment was first considered last summer, before the bill was reported. At that time there were no votes for the amendment. It was considered again in February. At that time there were four votes for the amendment. The testimony before the committee was that the President was in favor of the proposed legislation without the amendment. The amendment was opposed by the Federal Reserve Board, the Comptroller of the Currency, and the FDIC.

Mr. DOUGLAS. Mr. President, will the Senator yield for a supplementary question?

Mr. ROBERTSON: I yield.

Mr. DOUGLAS. Is it not true that while there were only 4 votes for the amendment, there were only 6 votes against it?

Mr. ROBERTSON: That is correct. The others were not recorded.

The PRESIDING OFFICER. The question is on the amendment offered by the Senator from Illinois [Mr. Douglas] for himself and other Senators. On this
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question the yeas and nays have been ordered, and the clerk will call the roll.

The legislative clerk called the roll.

Mr. JOHNSON of Texas. I announce that the Senator from New Mexico [Mr. Chavez], the Senator from Kentucky [Mr. Clemets], the Senator from Tennessee [Mr. Gore], the Senator from Massachusetts [Mr. Kennedy], the Senator from Oklahoma [Mr. Monroney], the Senator from Wyoming [Mr. O'Mahoney], and the Senator from Alabama [Mr. Sparkman] are absent on official business.

The Senator from Mississippi [Mr. Stennis] is absent because of a death in his family.

I further announce, if present and voting, the Senator from Tennessee [Mr. Gore], the Senator from Oklahoma [Mr. Monroney], the Senator from Wyoming [Mr. O'Mahoney], the Senator from Alabama [Mr. Sparkman], and the Senator from Mississippi [Mr. Stennis] would each vote "yea."

Mr. KNOWLAND. I announce that the Senator from Colorado [Mr. Allott] and the Senator from New York [Mr. Ives] are absent because of illness.

Mr. KNOWLAND. I announce that the Senator from Connecticut [Mr. Bush], the Senator from Idaho [Mr. Dworshak], the Senator from Arizona [Mr. Goldwater], and the Senator from Iowa [Mr. Hickenlooper] are necessarily absent.

The Senator from Vermont [Mr. Flanders], the Senator from Massachusetts [Mr. Saltonstall], the Senator from Utah [Mr. Watkins], and the Senator from Wisconsin [Mr. Wiley] are absent on official business.

The Senator from Wyoming [Mr. Barrett] is detained on official business.

On this vote, the Senator from Colorado [Mr. Allott] is paired with the Senator from Vermont [Mr. Flanders]. If present and voting, the Senator from Colorado [Mr. Allott] would vote "yea" and the Senator from Vermont [Mr. Flanders] would vote "nay."

Also on this vote, the Senator from Wyoming [Mr. Barrett] is paired with the Senator from Utah [Mr. Watkins]. If present and voting, the Senator from Wyoming would vote "yea" and the Senator from Utah would vote "nay."

The result was announced—yeas 58, nays 18, as follows.

YEAS—58

Aiken
Anderson
Barkley
Bridges
Byrd
Capehart
Case, N. J.
Cotton
Curtis
Daniel
Dirksen
Douglas
Duff
Eastland
Ellender
Ervin
Fulbright
George
Hennings
Hill
Holland
Hruska
Humphrey
Jackson
Jenner
Johnson, Tex.
Johnston, S. C.
Kefauver
Kerr
Kuchel
Laird
Langer
Lehman
Long
Magnuson
Mansfield
Martin, Pa.
Martin, Iowa
McCarthy
McClellan
McNamara
Millikin
Morse
Murray
Neely
Neuberger
Pastore
Payne
Potter
Purtell
Russell
Scott
Smathers
Smith, Maine
Smith, N. J.
Symington
Welker
Wofford

NAYS—18

Beall
Bennett
Bible
Bricker
Butler
Carlson
Case, S. Dak.
Frear
Green
Hayden
Knowland
Malone
Mundt
Robertson
Schoeppel
Thye
Williams
Young

NOT VOTING—20

Allott	Flanders	O'Mahoney
Barrett	Goldwater	Saltonstall
Bender	Gore	Sparkman
Bush	Hickenlooper	Stennis
Chavez	Ives	Watkins
Clements	Kennedy	Wiley
Dworshak	Monroney	

So, the amendment offered by Mr. Douglas, for himself and other Senators, was agreed to.

No. 22202

United States Court of Appeals
FOR THE NINTH CIRCUIT

ALBERT E. LEUTHOLD, Superintendent of Banks, State of Montana, Helena, Montana, SECURITY BANK, and MINERS BANK OF MONTANA, N.A.,
Appellants,

v.

WILLIAM B. CAMP, Comptroller of the Currency,
Appellee,

THE FIRST NATIONAL BANK OF BUTTE and DALY NATIONAL BANK OF ANACONDA,
Appellee-Intervenors.

On Appeal from the United States District Court for the District of Montana

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BRIEF FOR AMICUS CURIAE NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS

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---

BRIEF FOR AMICUS CURIAE NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS

STATEMENT OF THE CASE

The National Association of Supervisors of State Banks (the Supervisors) is filing this brief as amicus curiae pursuant to the written consent of all parties to the case. This brief is limited to the question of the standing to sue of the Superintendent of Banks of the State of Montana.

The Supervisors adopt the statement of the case found in the brief of appellants and set forth here only such additional facts as are necessary to show the interest of the Supervisors in this proceeding.

The National Association of Supervisors of State Banks was founded in 1902 and has 52 members. It is composed of the officials of the state governments responsible for the supervision of state chartered banking institutions in every state in the Union and of such officials in the Commonwealth of Puerto Rico and in the Virgin Islands. As of June 30, 1967, there were 9,487 commercial and mutual savings banks chartered under state law subject to the Supervisors' jurisdiction with total resources of approximately $237 billion.

The Board of Directors of the Association, consisting of Supervisor members, is the governing body of the Association under its Articles, having authority to supervise its affairs and determine its policies.

State banks were invited to join the Association as "associate" members beginning in 1958. There are currently 4,434 such dues paying associate members. Representatives from the associate membership advise and assist the Board of Directors.

The present system of federally chartered or national banks was created by the National Bank Act of June 3, 1864, C. 106, 13 Stat. 99, Rev. Stat. 5133-5156 (1875), 12 U.S.C. §§ 21 *et seq.* The Comptroller of the Currency is authorized to charter and supervise national banks under the provisions of that Act. As of June 30, 1967, there were 4,780 national banks with total resources of approximately $243 billion.

State banks under state charters and national banks under federal charter together compromise the "dual banking system" of the United States which has been in existence for over 100 years.

The Supervisors have a vital interest in their standing to bring such actions as the one in the court below. They are charged with the administration of the banking laws of their respective states. Therefore, their right to challenge actions, such as that complained of in the court below, which in their opinion constitute violations of those banking laws, is of considerable importance in carrying out the duties of their offices. For the reasons hereinafter stated, the Supervisors believe that the court below was correct in upholding the standing of the Superintendent of Banks of the State of Montana to bring the action below.

SUMMARY OF ARGUMENT

The sections of the National Bank Act relevant to the branching of national banks refer to and incorporate state law as the standard for determining whether national banks may open and operate branches in a particular state. Similarly, the Bank Holding Company Act refers to state law by providing that an out-of-state bank holding company may only acquire the shares or assets of a state bank when this is specifically authorized by the state laws of the state in which such bank is located.

The Superintendent of Banks of Montana is charged with the supervision of banks in that state and with the execution of all laws in relation to banks. Section 5-602, Revised Codes of Montana (1947). He also may close any bank which has violated any law of the state. Section 5-1101, Revised Codes of Montana (1947). Since the substantive law of Montana is applicable to the matters at issue in this case, even though the banks in question are national banks, it follows that the Superintendent of Banks of Montana, who is charged with the administration and enforcement of the substantive banking laws of that state, has a substantial interest in being able to challenge actions, such as those complained of below, which constitute violations of Montana's banking laws.

The courts of appeals of two other circuits have upheld the standing of state bank supervisors to bring such suits. *Jackson* v. *First National Bank of Valdosta*, 349 F.2d 71 (5th Cir. 1965); *Nuesse* v. *Camp*, 385 F.2d 694 (D.C. Cir. 1967). The only court holding to the contrary is that of the United States District Court in South Dakota and the conclusion of that court has been specifically rejected by both the Fifth Circuit and the District of Columbia Circuit Courts of Appeals. *South Dakota* v. *National Bank of South Dakota*, 219 F.Supp. 842 (D.S.D. 1963), *affirmed in part*, 335 F.2d 444 (8th Cir. 1964), *cert. denied*, 379 U.S. 970 (1965).

Not only the weight of authority, but the practical consideration of which persons would have an interest in enforcement of the state laws made applicable to national banks by the National Bank Act and the Bank Holding Company Act leads to the conclusion that the district court below was correct in upholding the standing of the Superintendent of Banks of Montana to bring this action. This result is also in accord with *First National Bank of Logan* v. *Walker Bank and Trust Company*, 385 U.S. 252 (1966), where the Supreme Court found that the purpose of Congress in enacting Section 36 of the National Bank Act was to insure competitive equality of national and state banks insofar as branch banking is concerned.

The only way in which such equality can be objectively assured is if the supervisors of banks in the various states have standing to seek compliance by national banks with the substantive state law to which they are subject. Otherwise, the only way competitive equality could be assured would be for the state supervisors to follow in all respects the interpretations which the Comptroller of the Currency or other federal officials may give from time to time to the branching and other applicable statutes of their states. This would not be in accord with the intent of Congress when it made state law the governing standard for national bank branching and prohibited out-of-state bank

holding companies from acquiring banks within a state unless specifically authorized by state law.

ARGUMENT

I. The Applicable Substantive Law To Be Applied in This Case Is That of Montana and, Therefore, the Superintendent of Banks of Montana Has Standing to Sue to Achieve Compliance with That Law.

Section 36(b) of the National Bank Act, 44 Stat. 1228, 12 U.S.C. 36(b), provides in relevant part as follows:

> "A national bank . . . resulting from the consolidation of a national bank . . . under whose charter the consolidation is effective with another bank . . . may retain and operate as a branch any office which immediately prior to such consolidation, was in operation as—
>
> "(A) a main office or branch office of any bank (other than the national bank) participating in the consolidation if, under subsection (c) of this section, it might be established as a new branch of the resulting bank . . ."

Subsection (c) referred to above specifically incorporates state law as the governing standard for the operation of branches. It provides:

> "A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches:
>
> * * * *
>
> at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State or State banks."

Similarly, the Bank Holding Company Act, Section 3(d), 70 Stat. 134, 12 U.S.C. 1842(d), provides that the acquisition of shares or assets of a state bank by an out-of-state bank holding company must be specifically authorized by the state in which such bank is located by language to that effect and not merely by implication.

The interest of the state official charged with the supervision of banking in his particular state appears on the face of these statutory provisions, since state substantive law must be looked to in each instance to determine whether a branch may be established and whether an out-of-state bank holding company may make a bank acquisition. Montana substantive law prohibits branches. Section 5-1028, Revised Codes of Montana (1947). Montana law further provides that upon consolidation the consolidated bank, if it meets certain qualifications, may retain and operate "offices" in the locations of the consolidating banks. Section 5-1124, Revised Codes of Montana (1947). There is probably no one more qualified to interpret and enforce these provisions of state law, which Congress has determined are applicable to the matter in controversy here, than the official charged with administering and enforcing them. If that official is denied standing to sue, the competitive equality which Congress sought to establish between state and national banks would be seriously threatened. *First National Bank of Logan* v. *Walker Bank and Trust Company*, *supra*. The courts of appeals which have considered this question in connection with the branching of national banks have uniformly come to the conclusion that state bank supervisors do have standing to sue.

While it could be argued that keeping national banks within the limits of the state laws applicable to them should be left solely to the federal officer charged with the supervision of national banks, the Comptroller of the Currency, such protection is patently insufficient to insure the "policy of equalization" decreed by Congress. First, the

Comptroller is concerned solely with the protection and supervision of the national banks. He has no inherent interest in insuring equality of opportunity for state banks. Therefore, he cannot be expected to dispassionately interpret and apply state laws to national banks. Secondly, the state is in the best position to interpret and apply its own laws. Finally, there may be instances where no state bank is affected immediately by the action of the national bank in violation of the state's laws or in which the state bank for any number of other reasons might not wish to challenge such violations. In such cases, the only party who could uphold the state's laws is the state itself. For all of these reasons, the Supervisors submit that as a practical matter the Superintendent of Banks of Montana must be held to have standing to sue in this instance where the state's interest is so clear and where Congress has been so careful to give controlling weight to it.

II. Where Congress Has Incorporated State Law as the Governing Standard the Weight of Authority Holds That State Banking Supervisors Have Standing to Sue.

Both the Fifth Circuit and the District of Columbia Circuit have now held that state bank supervisors have standing to challenge branching of national banks alleged to be in contravention of state branching laws.

In *Jackson* v. *First National Bank of Valdosta,* 349 F.2d 71 (5th Cir. 1965), the court upheld the right of the Superintendent of Banks of the State of Georgia to bring an action against a national bank on the grounds that it could not lawfully open a particular drive-in facility under the banking laws of Georgia. The Fifth Circuit specifically rejected the reasoning of the district court in the *South Dakota Case* concerning the standing of the state to bring such suits. The court noted that it was the substantive law of the state which was determinative of the issues before it and that in the absence of any contrary federal policies the remedial provisions of Georgia law should also be applicable. The court found that the state bank super-

visor was charged with the enforcement of the state's banking laws and was authorized thereunder to proceed against national banks as well as state banks for violation of those laws. The court held that since Section 36(c) of the National Bank Act adopts state law the application of that law would in no way interfere with the operation of national banks or conflict with federal authority and that "the subsumption of state substantive law as the regulating principle for national banking associations concerning branching carries with it the right of the State Superintendent of Banks to see to it that that substantive law is enforced."

The other court of appeals case upholding the standing of state bank supervisors to bring suits such as the one below is *Nuesse* v. *Camp*, 385 F.2d 694 (D.C. Cir. 1967). The District of Columbia Circuit first held that cases rejecting attempts by states or municipalities to intervene in law suits by virtue of their position as *parens patriae* were not in point for state bank supervisors have distinct legal rights of their own in their official station. The court then held that a state bank supervisor does have sufficient interest to bring an action to enjoin the Comptroller of the Currency from unlawfully authorizing a national bank to open a branch where state law would not permit branching by state banks. The court rejected the *South Dakota Case* reasoning and agreed with the *Jackson Case, supra.*

After deciding that a state bank supervisor had standing to sue in his own right, the court in *Nuesse* then dealt with his right to intervene in a suit brought by a state bank. The court's opinion on that issue points out with great force the state's interest in these matters. The court stated:

> "We not only have the greater impetus to intervention that inheres in administrative cases, but in addition the 'interest' of the state commissioner is underlined by the circumstance that the regulation of

> national banking is an area in which Congress, in the exercise of delegated federal power, has for various policy reasons decided to adopt and incorporate state law on issues of common concern. This admixture of national and state policies, attaching national legal force to the state policy, yields the corollary that a state official directly concerned in effectuating the state policy has an 'interest' in a legal controversy involving the Comptroller which concerns the nature and protection of the state policy."

The court found further support for the interest of the state bank supervisor in the recent decision of the Supreme Court in *First National Bank of Logan* v. *Walker Bank and Trust Company*, *supra*, and noted that:

> "Where Congress has been most deliberate in promoting a policy of equal opportunity by adopting state law on the subject, we think the courts may not be insensitive to the request by the official charged with administering the state's banking laws to appear as a party to urge the construction of the federal statute which he claims is necessary to secure the state's interests, and hence the congressional objectives."

Two Supreme Court cases decided prior to the adoption of Section 36(c) of the National Bank Act also support the standing of the Superintendent of Banks to sue below. In *First National Bank in St. Louis* v. *Missouri*, 263 U.S. 640 (1924), the Court upheld the authority of a state's attorney general to bring a *quo warranto* proceeding in the state supreme court to determine the authority of a national bank to establish and conduct a branch bank in St. Louis. The reasoning of the dissent in the *St. Louis Case* even supports the standing to sue of the supervisor in the present case. The dissent argued that only if the United States had adopted state law, as Congress subsequently did in Section 36(c), would the state have an interest sufficient to maintain the action.

Similarly, in *First National Bank of Bay City* v. *Fellows*, 244 U.S. 416 (1917), the court upheld the standing

of the Michigan attorney general to challenge a national bank's exercise of trustee powers. The federal act there permitted the Federal Reserve Board to allow national banks, "when not in contravention of state or local law", to act as trustees.

The reasoning that supports the standing of the Montana Superintendent to sue pursuant to Section 36(c) of the National Bank Act also supports his standing to enjoin violations of the Bank Holding Company Act, Section 3(d), 70 Stat. 134, 12 U.S.C. 1842(d) for that section permits the acquisition of the assets or shares of a state bank by an out-of-state bank holding company only when that is "specifically authorized by the statute laws of the State in which such bank is located".

As *Nuesse, supra,* makes clear when Congress has decided to adopt and incorporate state law on issues of common concern the interest of the state official charged with enforcing those laws is sufficient to bring suit. The Supreme Court's recent decision in *Cascade Natural Gas Corporation* v. *El Paso Natural Gas Company,* 386 U.S. 129, 135 (1967), also demonstrates that the Montana Superintendent had standing to sue to restrain an alleged violation of 12 U.S.C. 1842(d). There the Court ruled that the State of California was entitled to intervene as of right in a proceeding when "protection of California interests in a competitive system was at the heart of our mandate directing divestiture."

See also *First National Bank of Bay City* v. *Fellows,* 244 U.S. at 427-428, where the federal act permitted the Federal Reserve Board to allow national banks, "when not in contravention of state or local law" to act as trustees, etc. Whereas in *Fellows* the national bank could act in certain capacities only when not in contravention of state laws, in the present case out-of-state bank holding companies can acquire banks within a state only when permitted by state law. The phraseology may be different, but the principle is the same. The incorporation of

state law gives the state superintendent standing to sue under the Bank Holding Company Act, particularly where as here the holding company facade was used to evade and avoid the state's laws on bank branching.

The state superintendent was not precluded from bringing the action below by Section 9 of the Bank Holding Company Act, 70 Stat. 138, 12 U.S.C. 1848, since the method of review in the courts of appeals provided by that section is only applicable to review of orders of the Federal Reserve Board. *Whitney National Bank* v. *Bank of New Orleans*, 379 U.S. 411 (1965). That Board held no hearing and issued no order in this case since the defendants claimed they were acting pursuant to provisions of the Bank Holding Company Act which exempted them from the requirement of obtaining Board approval. The Superintendent below was challenging action of the Comptroller and not of the Federal Reserve Board.

Similarly, the claim that the only remedy for violations of the Bank Holding Company Act is criminal in nature and, therefore, the Superintendent lacked standing to bring a civil suit is in error. The Superintendent was seeking review of action taken under color of approval of the Comptroller. In other words, the Superintendent was seeking review of the Comptroller's action and was not seeking to enforce any penalty against the banks involved. As shown by the fact that the Justice Department is acting as the Comptroller's attorney in this case, it woud be futile to remit parties to sole reliance for relief upon the hope that the Justice Department would bring a criminal action against the banks involved. Thus, the only effective review mechanism for the Superintendent to challenge action of the Comptroller in alleged violation of the Bank Holding Company Act was in the district court below.

Intervenor-Appellees rely *solely* on the case of *South Dakota* v. *National Bank of South Dakota*, 219 F.Supp. 842 (D.S.D. 1963), *affirmed in part*, 335 F.2d 444 (8th Cir. 1964), *cert. denied*, 379 U.S. 970 (1965), to support

their argument that the Superintendent of Banks of Montana lacks standing to sue. The court of appeals in the *South Dakota Case*, however, held that the question whether the state had standing to enjoin the operation of the branch banks there had become moot because by the time of the appeal the Supreme Court of South Dakota had held invalid the banking commissioner's anti-branching rule under which it was claimed the branches were illegal. To the extent that the court of appeals held that the state lacked standing under the Bank Holding Company Act, 12 U.S.C. 1842(d), its reasoning should be rejected for the reasons previously discussed.

The South Dakota district court opinion relied upon the decision in *Millard* v. *National Bank of Detroit*, 338 Mich. 610, 61 N.W.2d 804 (Sup. Ct. of Mich. 1953), but the holding in that case was not that state bank supervisors do not have standing to bring suits such as that below. The *Millard Case* was concerned with the jurisdiction of a state court to hear the case and not with the standing of a state to bring suit in a federal court. Also, *Kerfoot* v. *Farmers & Merchants Bank*, 218 U.S. 281 (1910), relied upon by the South Dakota court, had no relevance to the point before the court since no application of state law was involved in that case. There it was alleged that the national bank was acting beyond its charter powers. No allegation was made that the national bank was acting contrary to applicable state law. *Kerfoot* held that only the sovereign can object if a corporation exceeds its charter powers. Thus, the *South Dakota* decision diverges from the mainstream of decisions on the question of supervisors' standing to enforce state branching laws against national banks.

Similarly, the unreported opinion in *Merchants & Miners Bank* v. *Saxon*, Civil Action No. 1042, W.D. Mich., June 7, 1966, is not in point and was not followed in *Nuesse, supra.* That opinion was concerned with the right of the Commissioner of Banking of the State of Michigan

to intervene in a case involving the right of a national bank to move its charter and main office from one location to another under Section 30 of the National Bank Act, 73 Stat. 457, 12 U.S.C. 30. The national bank had also filed an application to open a branch at the location of its old main office. The court held that the state had no interest in the interpretation of Section 30 which vested entire discretion as to whether a bank can move its location in the Comptroller of the Currency and made no reference to any state statute. The court found that although Section 36 (c) did refer to state law it was not presently involved in the case. The court said, "The interest of the state comes in only if, at the same time, the said defendant is permitted to open a branch bank in Lake Linden." The court thus implied that if Section 36(c) had been directly involved the state bank supervisor would have had an interest in the proceeding.

CONCLUSION

For the reasons stated, the district court was correct in holding that the Superintendent of Banks of Montana had standing to bring the action below.

Respectfully submitted,

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Supervisors of State Banks

CERTIFICATE

CALVIN DAVISON, one of counsel for Amicus Curiae, states as follows:

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing Brief is in full compliance with those rules.

CALVIN DAVISON
Attorney for Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that this Brief for Amicus Curiae has been served by mailing three copies thereof to each of the following counsel of record in this cause: Moody L. Brickett, United States Attorney for the District of Montana, Federal Building, Butte, Montana 59701 and Stephen R. Felson, United States Department of Justice, Appellate Section, Civil Division, Washington, D.C., Attorneys for Appellee; and to McKeon and Brolin 122-126 Oak Street, Anaconda, Montana 59711, Johnson & Johnson, 1st National Bank Building, Butte, Montana 59701, and John D. French, 1260 Northwestern Bank Building, Minneapolis, Minnesota 55402, Attorneys for Intervenor-Appellees; and to Donald A. Garrity, Assistant Attorney General, State of Montana, Mitchell Building, Helena, Montana 59601, Weber, Bosch & Kuhr, Citizens Bank Building, Havre, Montana 59501, and Hutton, Schiltz & Sheehy, 403 Electric Building, Billings, Montana 59101, Attorneys for Appellants.

Dated April 3, 1968.

CALVIN DAVISON
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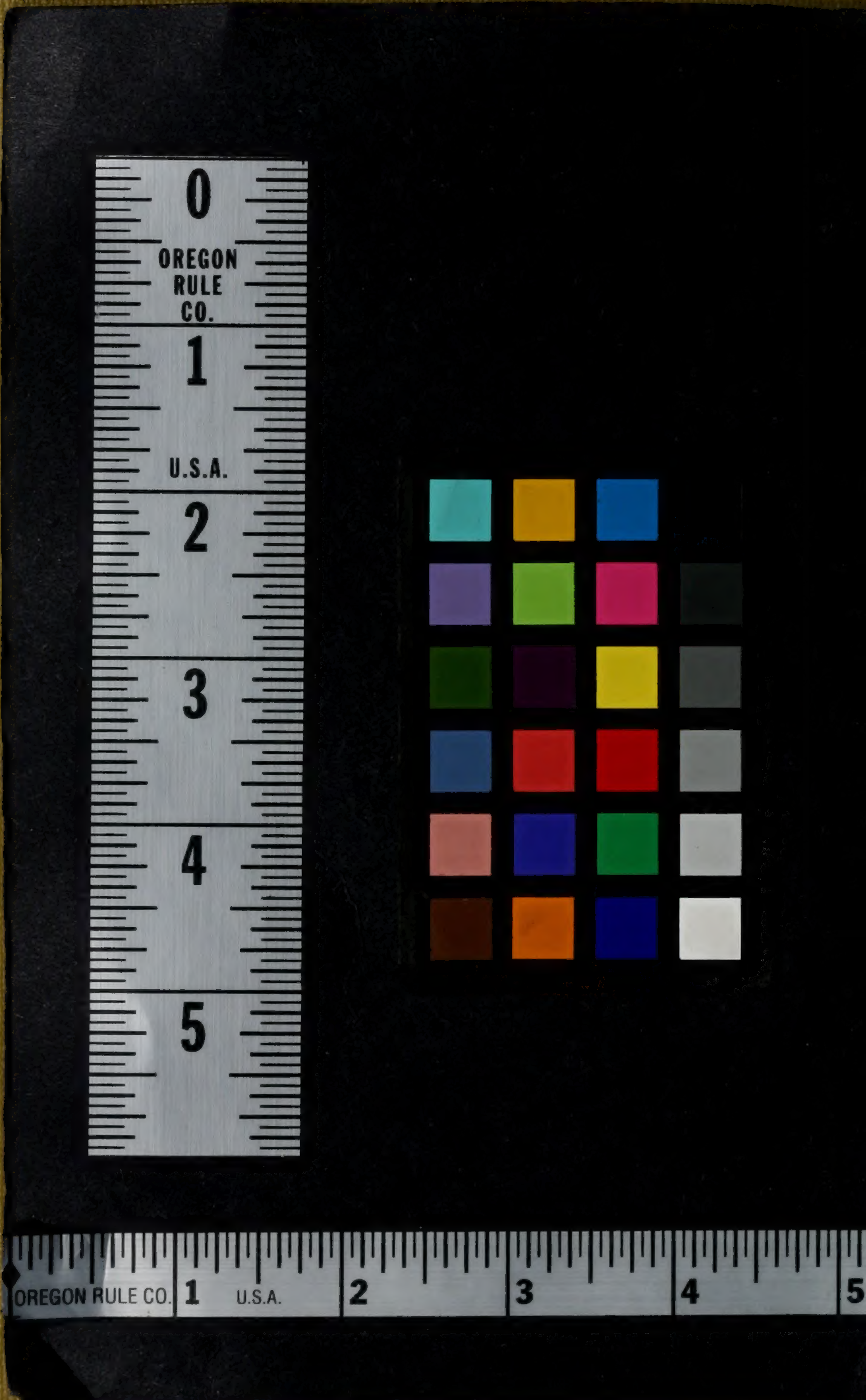
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